



## **The Political Economy of Scale: The Role of Closed-Membership Cooperatives in Rural Development**

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## **Purpose of Presentation**

### **Two Purposes:**

#### **1. Argue that New Generation Co-ops (NGCs):**

- Represent a local response to globalization
  - “politics of scale”
- Represent a shift from
  - Industrial Agriculture to “Civic Agriculture” (Lyson 2004)
- Relationship exists between Co-ops & Geography of social capital.

#### **2. Report on Two Surveys of NGCs**

- 2002 Mail Survey of 120 NGC board members
- 2003 Archival Survey of 231 NGCs in the US
  - Operating
  - Operational in the past
  - In development



## Outline

1. Rural Decline
  - Deindustrialization
  - Agricultural Decline
2. Rural Revitalization
  - Link Manufacturing + Agriculture
    - Competitive Advantage for Rural Regions
3. Cooperative Strategy—Politics of Scale
  - Industrial Agriculture versus Civic Agriculture
    - New Generation Cooperatives (NGCs)
  - Report on NGC Developments
4. Conclusions
5. References

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## I. Rural Decline

- Restructuring in Rural Manufacturing
  - Rural location as low-cost alternative to urban settings
    - Lower real estate prices
    - Lower unionization rates
  - Meatpacking from Chicago to IA, KS, MN, NE and elsewhere
  - Auto Sector from Detroit to rural IL, IN, KY, OH, TN, etc.
  - Deindustrialization in Rural America
    - Rural Midwest is no longer lowest cost site of production
    - “Right to Work” states lure jobs
      - PPI in Macomb to TN (200 jobs)
    - Outsourcing to Mexico
      - Maytag from IL to Mexico (1,600 jobs)
- Restructuring in Agricultural Sector
  - Farm Consolidation
  - Agribusiness Vertical Integration

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## I. Rural Decline

- **Farm Consolidation and Deindustrialization**
  - Leads to Rural Economic and Demographic Stagnation
- **Need New Rural Economic Development Strategy**
  - Focuses on both manufacturing and agriculture
  - Links both the farm and non-farm economy
  - Can we organize rural communities to achieve this?
    - Co-ops embody social capital which can ↑ civic engagement (willingness to become involved)
    - Organize farmers & others to achieve economic / political goals
    - Create jobs that will not leave to lower-cost regions
  - **Social Capital (Putnam 1995)**
    - Foundation for strategy to improve rural economy
    - 4 “Capitals”
      - Human (skills), Financial (\$), Physical (infrastructure), Social Capital
      - Social Capital—Social networks in a community

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## II. Rural Revitalization

- **Strategy of value-added agriculture**
  - Help farmers retain local control and \$\$
- **Concept of the value chain**
  - **Farmer ↔ Processing ↔ Marketing ↔ Retailing**
  - Shipping unprocessed goods—Profits, Jobs, Taxes elsewhere
  - Farm regions behave like “banana republics”
- **Farmers reach up value chain**
  - Add value to crops locally
  - Move closer to consumer—increase ROI
  - Focus on competitive advantage of rural regions
- **Process commodities locally**
  - Work with non-farm members of community
  - Build local processing facilities
  - Strengthen local social relationships—social capital
  - Generate jobs and increase on-farm income

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### III. Cooperative Strategy

- **Challenge for individual farmers who most likely can't afford:**
  1. Start-up capital
  2. Legal and tax issues
  3. Identifying product and market
  4. Technical expertise
  5. Environmental issues
  6. Management expertise
- **Solution—Producer Cooperatives?**
  - Accomplish as a group goals that cannot be achieved as an individual
  - Argue that Co-ops are a scale-based political-economic strategy that may allow groups of individuals to cope with globalization (Herod 1991; Merrett and Walzer 2003a).
    - Increase market presence—negotiate better prices
    - Raise startup capital—equity from co-op members
    - Create local economic multipliers—jobs and income
    - Shift away from **Industrial Agriculture** and towards **Civic Agriculture**
    - ↑ Social Capital / Networks of Relationships to confront globalization
  - Investment Risk—increased but shared among co-op members
  - Crop Risk—Geography / Scale spreads risk from disease and drought
- **Economies AND Politics of scale**
  - Organize producers and communities
  - Use co-ops to counter monopolies & monopsonies in Ag sector
  - Past success, but can they be successful in the future?

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### III. Cooperative Strategy

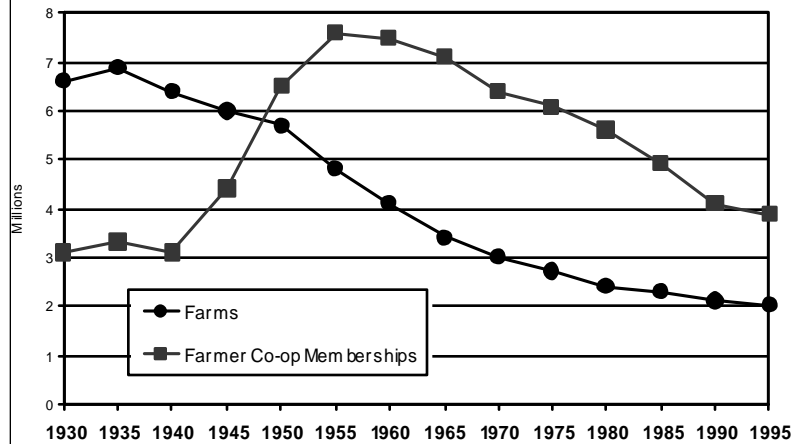
- **Cooperatives in the 19<sup>th</sup> Century**
  - Rochdale Co-op in England
  - The Grange in the US—buyers' co-ops and group insurance
  - Gilded Age (1860s to 1890s)
    - Social Inequalities lead to local responses
    - Anti-trust legislation
- **Cooperatives in the 20<sup>th</sup> Century**
  - Development of Co-op Law
  - Capper-Volstead 1922—Rise of Cooperatives
    - Exempted co-ops from anti-trust legislation
  - Decline of Traditional Cooperatives
    - Farms consolidate
      - fewer farmers = fewer cooperatives
    - Economic Restructuring / Post-Fordism
      - Consolidation in the agribusiness sector (Heffernan and Hendrickson 2002)
    - Second Gilded Age (Phillips 2002)
      - Neoliberalism and Deregulation (Harvey 1989)
- **Cooperatives in the 21<sup>st</sup> Century**
  - New grassroots economic models needed to respond to globalization and intensifying market forces
  - Parallels between late 19<sup>th</sup> century and late 20<sup>th</sup> century

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### III. Cooperative Strategy

- Farms and Farmer Cooperative Memberships in the US, 1930 to 1995.



Source: Merrett and Walzer (2003b); USDA (1998, 71)

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### III. Cooperative Strategy

- Problems with Traditional Cooperatives
  - Co-ops are more complex entities than traditional Investor-Oriented Firms (IOFs) (Egerstrom 2004)
    - Portfolio Problem
      - How to coordinate diverse interests
    - Free Rider Problems
      - How to convince members to patronize co-op when better prices exist elsewhere
      - Leads to undercapitalization and cash flow problems
      - Hinders ability of co-op to upgrade technology / compete
    - Horizon Problems
      - Liquidity of investment—co-op members feel trapped- NGCs can (potentially) solve these problems

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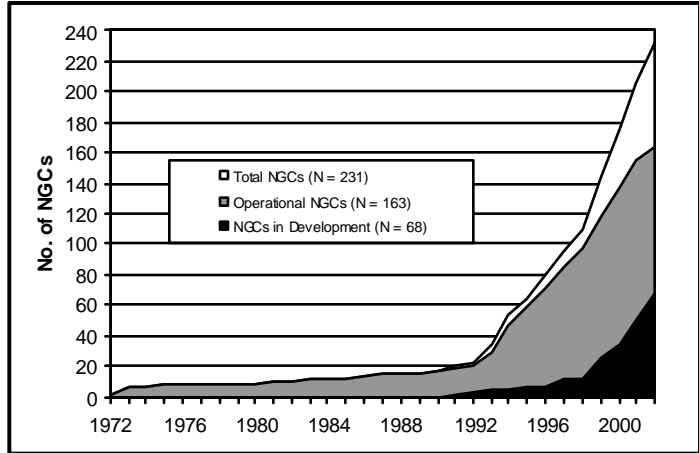
### III. Cooperative Strategy

Traditional Co-ops versus NGCs		
Issue	Traditional Co-op	NGC
Membership	Open	Closed
Size	Small to +10,000	~500 to ~3,000
Cost to join	Low (\$100)	High (+\$5,000)
Delivery Rights and Obligations	Broad / Not usually	Required
Liquidity of Investment	Not usually	Shares traded on open market
Expected ROI	< 8%	10 to 20%
Mindset	Commodity Grower	Entrepreneur (↑ Risk)

Source: Fulton (2001)



### NGCs Operating or in Development, 2003



Source: Merrett et al (2003).



### III. NGCs / LLCs by Sector

Sector	No.
Corn—Ethanol	72
Soy beans Oilseeds	20
Pork	19
Wheat	16
Beef	14
Fiber Processing	12
Beans and Legumes	10
Sugarbeets	10
Vegetables	10
Fish Production	9
Diversified Grain Processing	8
Producer Alliances	8
Dairy	7
Poultry	7
Sheep and Goats	6

Sector	No.
Biotech / Biopharming	4
Alfalfa	4
Eggs	4
Forestry	3
Organic Grains	3
Bison	3
Corn—Edible Products	2
Farmer-owned Restaurants	2
Barley	2
Oats	2
Grapes	2
Cranberries	2
Deer and Elk	2
Rice	1

Source: Based on data in Merrett et al (2003) 13



### Estimates for Operational US NGCs, 2004

Numerical Category	Co-op Members	Jobs Created	Total Startup Cost (\$)	Farmer Equity (\$)
N (Co-ops reporting)	142	53	86	77
Missing (Co-ops not reporting)	23	112	79	88
Average per Co-op	489	251	29,025,000	12,028,000
Median per Co-op	258	90	21,250,000	9,200,000
<b>Total in the U.S.</b>	<b>69,404</b>	17,365	2,766,300,000	1,106,556,000

Source: Merrett et al (2003).



## Operational Status of US NGCs

Operational Status (09/04)	Number
<b>NGCs in the US</b>	<b>235</b>
<b>Operational now or at one time</b>	<b>165</b>
Operating now as a closed co-op	131
Conversion to/acquired by/partnership with IOF	5
Under Construction	6
Bankrupt/dissolved/suspended operations	23
<b>In development</b>	<b>70</b>
Equity drive	7
Pre-equity drive	59
Status unknown	4

Source: Compiled from data in Merrett et al (2003).

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## III. Reasons Farmers Join NGCs

Reasons for Starting the NGC	Average Rating***
Capture More Value From Crops	4.91**
Vertical Integration of Farm Markets	4.67**
Help Members Identify Niche Markets	4.60**
Help Members Cope with Market Volatility	4.60**
Increase Local Farm and Non-Farm Income	4.59**
Low Commodity Prices	4.56**
Help Producers Be More Competitive	4.56**
Help Producers Enter New Markets	4.43**
Cope with Declining Farm Supports	4.16**
Environmental Regulations	3.21
Need to Create Jobs in Rural Community	3.12**
Increasing Costs of Technology	2.94
High Unemployment Among Farm Families	2.91
Tax Advantages of Cooperatives	2.89
Experience with Previous Cooperative(s)	2.59
Free Trade and Globalization of Markets	2.59*
Raise Capital to Expand Existing Business	1.55**
Replace a Processor that Had Closed	1.50**

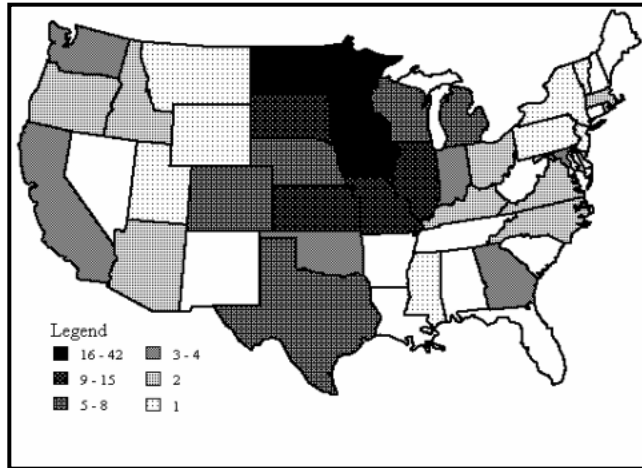
\*\*\* Scale of 1 to 5, where 1 = not important and 5 = very important.  
 \*\* Chi-square test, p < .01; \* p < .05; N = 60 of 120 NGCs surveyed (2002)  
 Source: Merrett and Walzer (2001)

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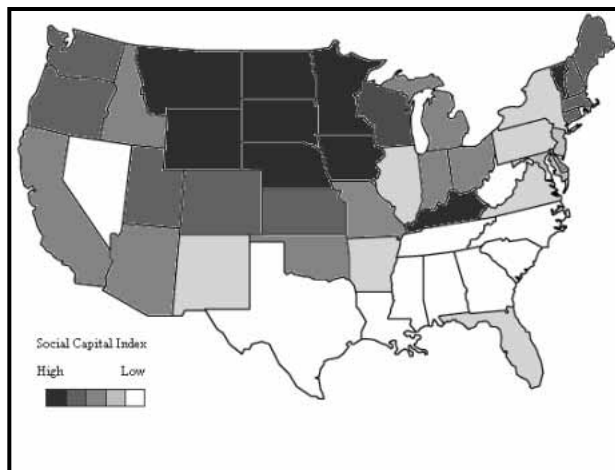
### III. Cooperative Strategy

- Regional Distribution of NGCs, 2003



### III. Cooperative Strategy

- Index of Social Capital





## Relationship Between Location of NGCs and Social Capital

Variables	Social Capital Index	Co-ops (2002)	NGCs (all stages of development)	Operational NGCs
Social Capital Index	1	.329*	.527**	.531**
Co-ops (2002)	.329*	1	.791**	.792**
NGCs (all stages of development)	.527**	.791**	1	.968**
Operational NGCs	.531**	.792**	.968**	1



## IV. Conclusions

- NGCs show how producers & rural communities can collaborate to confront globalization
- NGC failure rate lower than typical new business startups which is about 50% after 5 years
- NGCs create industrial base using rural inputs
  - NGCs less likely to shift production to Mexico
- NGCs may not be a panacea for Rural America
  - Regional cultures
    - community versus individuals.
    - Does social capital matter?
  - Correlations between NGC location and geography of social capital raise questions about success of cooperatives in other regions
  - Market structure—ADM & Cargill.
  - NGCs expensive: \$15 to 200m.
  - Helped some communities but failures too.
- NGCs exemplify creativity of rural regions
  - Creativity / new business models to sustain rural communities





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