Economics for CED Practitioners

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Introduction

Despite the growing popularity of community economic development (CED), it remains under-theorized in economic, political and sociological terms.[ii] On the economic side, there are two main reasons for this. First, CED is itself a vague concept open to many different definitions and approaches. This makes it difficult to develop a coherent theory to explain it. We shall return to this problem later. Secondly, orthodox economic theory has no interest in CED however it is defined. It is preoccupied with models of profit maximization, short-run efficiency and individual self-interest, within a framework that accepts perfect competition as the ideal industrial structure. Since actual industrial organizations deviate from this structure, they are considered to be less than optimal in terms of efficiency and that becomes the focal point of interest in the theory. Huge sectors of the economy in which the market plays only a peripheral role, what Bakker and Elson (1998) have called the 'care economy', in which women's labour figures prominently, are excluded from the analysis, even though the market economy could not function without them. The logic of this underlying competitive model is one of increasing scale, concentration and centralization, a logic which results in 'inefficiency' being the norm rather than the exception. Class, gender and regional inequalities are the inevitable outcome of this theoretical model but are treated only as irrational occurrences that would disappear if the market were given free reign. State intervention is called upon to ameliorate these inequalities, both to minimize resulting social friction and to assist the process of private accumulation. State subsidization of the private sector is intrinsic to the system and is both overt, as in the granting of concessions to attract business to a particular geographic location, and hidden, in the form of tax expenditures or state support of health, education and infrastructure, upon which the private sector is dependent (O'Connor, 1973). Ideologically, however, the private sector is considered to be a distinct sector driven by creativity and entrepreneurial spirit and its dependence on the state is not acknowledged in mainstream theory.

The theory makes no attempt to consider alternative, more cooperative forms of industrial organization, nor to assess what the macro, economy-wide, implications of their growth or

widespread adoption might be. CED would fall into this group, calling for a different approach to economic theorizing, in so far as it is driven by motivations other than those of private accumulation and narrow self-interest.

CED as a Challenge to Economic Orthodoxy

One of the difficulties in theorizing about CED is the eclectic nature of its definition. To some, CED covers any economic development initiative, be it private, public or community driven, taking place within some definition of 'community', usually a geographic one. On this view, there is no necessary inconsistency between orthodox economics and CED. On more demanding definitions of CED which are coming to dominate the literature, more radical departures from the orthodoxy seem called for (see, for instance, Canadian CED Network, 2004; Loxley, 1986). These define CED as a social process in terms of decision taking; they replace the individual 'consumer' with the collective community; they see the meeting of collective 'needs' taking precedence over the satisfaction of individual consumer 'demands'; they do not artificially split decisions about production from those about consumption, as the orthodoxy does; they take a long view of economic activities as opposed to that of short-term profit maximization and they see economic decisions as being inextricably linked to social, environmental, political and cultural considerations.

Within this more demanding view of CED, there are two schools of thought. The first, associated with a more radical, communal, tradition, sees CED as an alternative form of social organization to capitalism. The second has a more limited vision, seeing CED as a desirable and workable approach to dealing with particular problems facing communities, such as 'unemployment, poverty, job loss, environmental degradation and loss of community control' (Canadian CED Network, 2004). These problems are a direct outcome of the way in which capitalism differentially and unevenly affects certain communities and CED is seen as a way to help fix them, within the confines of the capitalist system as a whole. Adherents to the first school are often found working alongside those of the latter on the grounds that building viable CED projects might help people see the feasibility of an alternative economic and social system based on CED principles.

The most complete set of CED principles are those underlying the Neechi model of CED. Neechi Foods Co-op Ltd. is an Aboriginal worker-owned cooperative retail store in Winnipeg. The idea of this approach is to build a strong, inward looking, self-reliant economy which is based on goods and services consumed by people who live or work in the community. In theoretical terms it is a **convergence** strategy of economic development (Thomas, 1974). It

favours cooperative ownership, small scale production and popular control over economic decision making. It is a holistic approach, in which the safety, health and self-respect of residents are of paramount importance (Loxley, 2002). The principles on which it operates are as follows: production of goods and services for local use; use of local goods and services; local re-investment of locally generated profits; long-term employment of local residents; local skill development; local decision making; improved public health; improved physical environment; neighbourhood stability; human dignity and solidarity among communities and businesses following these principles.

This strategy of CED can be contrasted with alternative ones which implicitly assume communities are too small to offer economic opportunities based purely on the local market and hence should build their base on **exporting goods or services**. This assumes the logic of large scale production and the logic of orthodox economics. The range of alternative economic approaches to CED are best exemplified by contrasting, in detail, export base approaches with that of the Neechi model and it is to this that we now turn.

Export base approaches

Export base approaches are a common strategy where production within the community is geared to satisfying market demand outside the community. These approaches are grounded in export base theory, a theory of regional economic growth and development, pertinent to community economic development as a community can be considered a smaller region. Export base theory is grounded on the assumption that all economic activities in a community are a function of export activities and export expansion is the primary source of economic growth. The theory postulates that growth in a community is largely determined by the success of its exports either from an improved cost position of existing exports relative to competing areas or as a result of the development of new exports (North, 1955).

The export base becomes instrumental in shaping the distinctive quality of the community's economy. The economic base model conceptualizes the economy as two sectors, the export or "basic" sector and the non-export or "non-basic" sector. The basic sector consists of all economic activity whose final market lies outside the community and the non-basic sector consists of all economic activity whose final market is local. Total economic activity is a function of export activity. Employment and income in the basic sector are a function of external demand for a community's exports. (Davis, 1993; Hewings, 1977)

Economic base analysis is a tool of regional economics used to examine the economic impact of export activity in a region or community. Total economic activity, Y, is modeled as a function of export activity, E, in the equation $Y = (1+k)\,E$, where k is the ratio of non-basic

activity to basic activity (k = N/B). $1 + k$ is the multiplier which will always be greater than one, assuming some non-basic activity exists. The equation explains that if export activity increases, then total activity increases by the amount of the change in export activity times the multiplier.

Export base theory is a derivative of the staple[iii] theory of growth, a Canadian theory developed to explain the economic development of Canada as a process of diversification around an export base (Watkins, 1963). The central concept of staple theory is the spread effects of the export sector, in other words the impact of export activity on the local economy and society. The range of investment opportunities in domestic markets or the extent of diversification around the export base is determined by the demand for factors, the demand for intermediate inputs, the possibility of further processing and the distribution of income.

Staple theory analyzes the impact of export expansion on the economy by classifying the income flows. The inducement of domestic investment resulting from increased export activity can be broken down into three linkage effects: backward linkage, forward linkage and final demand linkage (Hirshman, 1965; Watkins, 1963). A backward linkage is a measure of the extent of expenditure on community produced inputs, including capital goods. Backward linkages are created when input requirements are comprised of resources and technologies produced or owned by the community. A forward linkage is a measure of the extent that a sector's output is sold as inputs to other sectors of the community. A final demand linkage is a measure of the extent to which domestic industries are producing consumer or investment goods for use in the community. The greater the proportion of domestic production sold inside the region, rather than as exports, the larger the final demand linkage effect will be. Linkages are also determined by supply-side expansion of the export sector, the degree of which depends on the relationship between staple production and the supply of entrepreneurship and complementary inputs, including technology.

If the staple or staples generate strong linkage effects which are adequately employed to the community's advantage – then eventually the economy will grow and diversify to the point where the term "staple economy" will no longer apply (Watkins, 1963).

The cyclical sensitivity of the region is ultimately determined by the export staple. Specifically, income elasticities of export staples are the major determinant of cyclical sensitivity in a community (North, 1955). A region with a narrow export base is more prone to disturbances resulting from changes in income levels in other regions than a region with a broad, more diversified export base. Income elasticity of demand for the export staples is a critical determinant of vulnerability to economic fluctuations.

Export base theory is limited in that it is only appropriate for small, isolated economies whose growth and development are dependent on export-oriented industries (Davis,1993). The theory fails to acknowledge sources of economic stimuli other than exports, such as the other components of gross regional product, such as consumption, government expenditures, and

business investment and the volume of residential construction. Exports are neither the only nor the most important source of economic stimuli. In fact it has been found that economic activities are rarely a function only of export activities (Loxley, 1986).

The role and source of capital is a critical component of export-led development. Since new communities typically depend on imported capital to develop their export staple industries, it is the external investors who decide on the investment projects. External investors are typically reluctant to invest in new, unproven activities where risks are greater, thus new investment goes to expanding the base rather than diversifying the local economy (North, 1955). Resource firms do not tend to diversify and linkages are rarely established at the point of production of the export commodity. Many of the exports are products with little or no further processing from raw material (Watkins, 1977). Further, profits from the imported capital typically flow out of the community, reducing linkages.

Environmental concerns may result from outside ownership of capital. Schumacher (1973) argues community ownership is preferable in that " men(sic) organised in small units will take better care of *their* bit of land or other natural resources than anonymous companies or megalomanic governments which pretend to themselves that the whole universe is their legitimate quarry"[iv].

The term leakage is used as a measure of the income flows leaving a region through sources such as migratory labour, servicing of capital imports, immigrant's remittances abroad, to name a few. The development of a resource base into a staple export does not necessarily lead to community economic development. Historically, export based economies do not diversify and linkages are rarely established at the point of production of the export commodity. Many of the exports are products with little or no further processing from the raw material. Loxley (1986) describes staple economies as divergent, a concept introduced by C.Y. Thomas (1974), implying what is locally produced is not locally consumed and what is locally consumed is not locally produced.

Convergence or Community Based Economic Development

A convergence or community based approach attempts to match community needs to locally available resources (Wismer and Pell, 1981). This inward focused approach suggests the convergence of local use and demand through the creation of a series of industries producing "basic goods" – goods which feature prominently in the production of a wide range of consumption and investment goods (Loxley, 1986). The nature of the community resource base and the structure of community demand and needs determine the choice of products to be produced. Community participation and ownership are necessary components of convergence and community-based approaches because they play a part in reversing income flows, reducing

income inequalities and ensuring production meets community demand and needs (Loxley, 1986).

A convergence approach is somewhat compatible with a subsistence strategy, as the very nature of subsistence is the convergence of local resources with need. However, a convergence strategy goes well beyond a subsistence strategy to integrate production for monetary exchange and suggest how this might be organized (Loxley, 1986).

The economic theory underlying this approach perceives underdevelopment as a consequence of increasing divergence and unresponsiveness of domestic production to meeting the needs of the local community (Thomas, 1974). The divergence, in part, describes a lack of self-sufficiency. Foreign ownership and control of domestic resources is a key element of divergence. The economic development process transpires through economic activity with an inward focus, a convergence of a community's resource base with the community's demands and needs. Production decisions are based on the demands and needs of the community rather than demands from outside the community (exports). For example, the retailer Neechi Foods, an Aboriginal worker co-op in inner-city Winnipeg, employs community residents, sells products considered to be most needed in the community, does not sell cigarettes, and subsidizes the sale of fruit to children.

The import domestic expenditure coefficient, a quantitative measure of divergence, relates the value of imports for domestic use to domestic expenditure (Thomas, 1974). This measurement provides relevant information on the extent of the gap between the structure of production and the structure of demand which traditional import indices, such as the measurements of import propensity (ratio of imports to GDP) and the import coefficient (ratio of imports to total expenditures), do not divulge. A community whose import domestic expenditure coefficient is close to one is described as a divergent economy, whereas a community whose coefficient is close to zero is described as a convergent economy. Disadvantaged communities typically have import domestic expenditure coefficients close to one meaning that nearly all domestic spending is on goods and services imported into the community. The import domestic expenditure coefficient is useful for planning development strategies. For instance, development strategies based on principles of the Neechi model aim to reduce the import domestic expenditure coefficient through small business initiatives to provide goods and services consumed by those who live and work in the community.

The formation of linkages among the different production sectors is the mechanism through which community economic growth and development occurs. Staple theory (Watkins, 1963), convergence theory (Thomas, 1974), big push theory (Lynn, 2003), as well as theoretical work by Loxley (1986), all emphasize the importance of linkages for economic development. For instance, backward linkages are created when Neechi Foods purchases moccasins and other

home-made crafts made by Aboriginal women in the neighbourhood for sale in their store. Forward linkages would be created if Neechi Foods were to sell food items to a community bakery or restaurant. Final demand linkages are formed by Neechi Foods's objective of offering a better selection of food at better prices to community residents. Neechi creates further linkages by purchasing wild rice and wild blueberries from Native communities outside of Winnipeg which are also working on building community self-reliance. The maximization of linkages and the minimization of leakages strengthens the growth and development process. Optimization is achieved to the extent that production is locally owned and profits stay within the community, and that the production output is sold to other businesses and individuals within the community.

The issue of scale is imperative to convergence and community- based approaches to community development (Schumacher, 1974; Thomas, 1974; Wismer and Pell, 1981; Loxley, 1986). Small scale production is perceived as being desirable because it allows for a more spatially balanced economy, a less impersonal work environment, the possibility of community participation and control and the opportunity to tailor technology to local skill and employment levels (Loxley, 1986). As well, small scale production is more compatible with the environment: "small-scale operations, no matter how numerous, are always less likely to be harmful to the natural environment than larger-scale ones, simply because their individual force is small in relation to the recuperative forces of nature"[v].

The emphasis on small scale production for community development may be in conflict with microeconomic theory which generally supports the view that economies of scale are crucial in determining the nature and levels of production. Those who support a convergence approach to community development argue that minimum efficient scale is not as important for deciding levels of production as the critical minimum level of production [vi] (Thomas, 1974). They argue that most benefits of large scale production accrue at or below the critical minimum level of output, which may be well below output levels at which unit costs are minimized. The economic and social benefits stemming from the formation of inter-industry linkages are viewed as being more important than economies of scale in community development (Loxley, 1986). Nonetheless, a convergence approach acknowledges that small scale projects will normally carry higher unit costs than larger scale projects, and that subsidies to firms may be required to compensate for the foregone benefits of large-scale production. As well, unit costs can be minimized through inter-community cooperation, minimizing capital costs through multi-usage of facilities, and perhaps a shorter work week. Exports can play a pivotal role by enlarging the market just enough so that unit costs can fall to their critical minimum level. Trade outside the community, thus, serves a different function than in export base theories because exports serve only to extend domestic demand and domestic need (Thomas, 1974).

The higher costs of small scale production may also be offset by external economies, in

which the costs or revenues of any individual community enterprise may be improved by the existence of other enterprises in the community. External economies contribute to growth and development by improving a community's competitive cost position and can be developed through linkages as well as activities such as creating marketing organizations, credit facilities, labour force training programs , housing projects, recreation centres and social institutions (Blakely, 1984).

A convergence approach faces challenges on the issues of community ownership and on its political assumptions. It is reasonable to expect fundamental opposition to approaches emphasizing community ownership from those who control the economy and those who hold power. The main challenge is that this approach requires basic and long term state support which it may be denied if it challenges the private sector or empowers the community to voice its demands and discontents (Shragge, 1993).

A pure convergence strategy is based on very ambitious political assumptions. It assumes that the political system is able to regulate or prohibit trade flows, impose taxes, take property into public sector hands, redistribute income and plan production (Loxley, 1986). Such a political system stands in contrast to the dominant one in present day society, in which unfettered free markets and the minimization of the role of the state are held as the formula for development. Yet, the importance of state funding to communities, state control of land and natural resources, the existence of large crown corporations and the openness to community-based approaches, provide rough proxies to some of the assumptions stated above. In Canadian society, at best only approximations of a pure convergence approach can be followed (Loxley, 1986).

Other CED Strategies

Between these two extremes, three other strategies of CED can be identified (Loxley, 1986). The first, which is really a strategy of defeatism or despair, is that of a social assistance/migration strategy, where the state and the community have effectively given up on economic development and people either survive locally on transfer payments or leave the community for other centres. This approach has characterized state policy towards some, often relatively isolated, communities, and underlies so-called 'market solutions' to Aboriginal economic problems (see, Riggs and Velk, 1993). The problem with this approach is that the lack of local economic development opportunities is often assumed, *a priori*, rather than concluded after detailed examination of possibilities. A second problem is that economic conditions for migrants are often little better in towns than they were in the relatively isolated communities from which they came. Market solutions are, therefore, often no solution.

In many communities, the provision of government services provides the main or an important aspect of economic strategy, from local government, to infrastructure building and maintenance, schools, health care facilities, policing and garbage disposal. In many Aboriginal communities, these activities account for most jobs and a high proportion of community income.

Finally, some communities pursue what economists would describe as an import substitution strategy, providing services and producing goods locally which were previously imported. The local provision of government services is particularly attractive to communities, implying local people take over jobs previously occupied by people from outside the community, because scale is less of an issue than the import substitution of goods, the jobs are relatively secure and long term and it also implies a greater degree of local control. The replacement of non-government services and imported products may face problems of scale but their market demand is known with a degree of certainty. Import substitution has a role in convergence strategies but the latter do not accept the existing distribution of income, and hence current market demand, as a given. Nor do convergence strategies accept that output should be driven only by the market, placing a much greater emphasis on meeting *needs* as opposed to *demand*.

The Role of Subsidies in CED

Underlying most approaches to CED is the philosophy of self-reliance and community independence. In reality, however, given that CED ventures have to compete with other, often monopoly producers, having to accept prices fixed by them which are based on much larger scales of production and wages close to or below subsistence levels (e.g. Walmart), in reality, few CED projects would be viable without some degree of subsidization. Their scale of production is usually very small, overhead costs are relatively high, wages paid have to be at socially acceptable levels, staff are often inexperienced and need training and they often face social problems not necessarily experienced by the general labour force. For all these reasons, and until prices generally in the economy are arrived at by considerations other than those of short-run, market driven, profit maximization, CED projects will find it difficult to prosper. Many require a degree of subsidization in order to survive. Subsidies can take many forms; from someone picking up the bottom-line losses of a project, to providing a wage or training subsidy, a protected market for products at a higher than market price, physical assets at less than cost, cheap capital, a protective tariff or tax on competitors' products, or help towards meeting overhead costs. All of these can be found in one form or another around the world.

In places where CED is very well established along convergence lines so that many enterprises and agencies are providing a range of goods and services, some products may be subsidized by

others, so that what is called 'cross-subsidization' is taking place e.g. a community owned credit union may provide credit on favourable terms to other community based projects: a locally owned restaurant may be supplied with locally produced food at higher or lower than market prices. Or it may be the case that most locally produced products are being sold at higher prices than available elsewhere, i.e. consumers are subsidizing all the CED operations. What is the economic rationale for these various forms of subsidization?

Usually one resorts to principles of cost-benefit analysis to justify subsidization. Projects that are commercially unviable may be socially viable if the market does not accurately capture the true costs and benefits to society of the project in question. Market prices do not normally capture the true *opportunity cost* of employing resources. Thus, it is argued, in a community experiencing widespread unemployment, the true social cost of employing labour is not the wage that would have to be paid to hire workers, but rather the loss of output to society of offering these people a job. Often, that loss is zero or negligible and hence a subsidy could be justified by putting wage costs well below their market cost, thus improving the apparent profitability of the project. The state or some other entity would have to pay the project the difference between the market wage costs and the social wage cost and the rationale for this subsidy is, therefore, one of job creation. Similar arguments can be made for projects that provide training to workers, external economies to other sections of the community or reduce social problems in the community. The correct way to proceed is to calculate true social costs and benefits, see what this does to the bottom-line of the project and limit subsidies to the amount by which they turn red-ink into blue ink in the accounts of the project.

In reality, these calculations are often difficult to make and governments and politicians find them hard to follow. Where this is the case, another closely related approach may be pursued. This consists of measuring the *fiscal impact* of a project and gearing the amount of subsidy to the extent to which the project improves the fiscal position of government(s). Such improvement may come from a number of different sources. First, if the project increases employment it may reduce either Employment Insurance (EI) claims (which are expenditures in the federal government budget) or social assistance payments (usually paid by provincial or municipal governments). Secondly, workers pay EI contributions which increase government revenue as well as income, sales and other taxes. Thirdly, if projects reduce social problems, by tackling them either directly or indirectly, e.g. by putting people to work, then government spending to address social problems will go down. In theory, it is possible to add up all these positive fiscal impacts and justify government subsidization accordingly. Politicians can relate more easily to this approach and find it more accessible than justifications based on cost-benefit analyses. Though there are similarities in the two approaches, they can and will normally give different

results for the amount of subsidy being justified. One potential problem with the fiscal approach is that net fiscal benefits are spread among the different levels of government, and the level of government benefiting most may not be the one that has the most subsidy available. Nonetheless, fiscal impact studies are worthwhile undertaking to justify state support for CED undertakings.

The extensive cross-subsidization of CED projects in a community through higher final sales prices than those in neighbouring communities, is justified by reference to the jobs created by the projects which would not otherwise exist. Members of the community could probably buy the products of each individual project more cheaply elsewhere, but if they were to do so, they would lose jobs and incomes in the community and community economic and social coherence would be reduced.[vii] In this respect, support for CED projects is not unlike support for fair trade products or cooperatives generally; consumers may have to pay more to support broader social goals.

Subsidies may be a feature of all alternative strategies of CED, except, by definition, a pure subsistence strategy. Thus, an export strategy may not work if production costs are too high to compete in the external market and import substitutes may need some form of protection to compete against cheaper goods and services produced outside the community. In a convergence strategy, some activities, such as housing, education and training, take on a huge importance because they immediately serve to address basic peoples' needs as well as provide sources of income, employment and linkages. Where state and third sector funding is available for these activities, i.e. implicit or explicit subsidization, they can form the basis of a convergent CED strategy.

Another source of 'subsidization' of projects is the voluntary labour input of members of the community. This is often important and under-recognized. It is also often gendered, with women playing disproportionate roles.[viii] Pursuing a convergence strategy might, therefore place new demands on community members, especially women, and this needs to be recognized. Successful pursuit of the strategy might, however, reduce other burdens on women, by improving child care facilities, creating job opportunities, improving incomes and reducing social problems that face them or demand their attention.

Summary and Conclusion

This contribution has attempted to throw light on aspects of the economics of CED thought to be important to CED practitioners. For that reason it has attempted to examine different

philosophical approaches to CED as well as different economic strategies of implementing CED. The economics of CED cannot be separated from this broader discussion given the competing views of what CED is and how one should go about implementing it. There is no single 'right' or 'wrong' way of proceeding, but the vision chosen and the strategy pursued will each have their own economic implications. Common to all approaches, when attempting to pursue CED within capitalism rather than as a replacement for it, will be the need to find sources of support for projects that allow them to compete against much larger capitalist alternatives. As the CED options expand, state subsidization may be replaced by broader consumer support through cross-subsidization, or social pricing.

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Footnotes

i. John Loxley is Professor of Economics and Laura Lamb is a doctoral student. We are happy to acknowledge the generous financial support of the Initiative on the New Economy of the Social Sciences and Humanities Research Council; via the Manitoba Research Alliance on Community Economic Development in the New Economy. For further information please see:
http://www.brandonu.ca/organizations/rdi/MRA.html

ii. The economic, political and sociological theory of CED is being examined as part of the Manitoba Research Alliance on CED and the New Economy SSHRC-funded research agenda.

iii. The term staple refers to the main commodity produced by a region. It is generally thought of as describing products of extractive industries.

iv. E.F. Schumacher, *Small is Beautiful* (New York: Harper Colophon, 1973), 34.

v. Schumacher, 33.

vi. Minimum efficient scale is that production output at which unit costs are at a minimum. The critical minimum level is the production output at which the rate of fall in unit costs, as output increases, is at its greatest.

vii. This problem is captured graphically in the film about the experiences of Evangeline in Prince Edward Island, *We're the Boss (National Film Board, 1990)*.

viii. Issues relating to women and CED are dealt with more extensively below in the chapter by Melanie Conn.

The study investigates the underlying factors that drive forced labour, of which a major one is illegal profits. Figures include a breakdown of profits by area of forced labour and by region. Full report - [pdf 1.2MB]. Summary of the report - [pdf 0.1 MBâ€Ž]. ILO's Director-General urges immediate action to eradicate forced labour. Views on forced labour from the ITUC. Forced labour cannot be accepted by anybody. Sharan Burrow - International Trade Union Confederation (ITUC). from employers.