ATILIM UNIVERSITY
GRADUATE SCHOOL OF SOCIAL SCIENCES
DEPARTMENT OF ECONOMICS
PHD PROGRAM IN POLITICAL ECONOMICS

COOPERATIVE RATIONALE: AN EXAMINATION OF STABILITY IN CONTEMPORARY POLITICAL ECONOMY

PhD Dissertation

Bülent Temel

Ankara-2015

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ACCEPTION AND APPROVAL

This is to certify that this dissertation titled "Cooperative Rationale: An Examination of Stability in Contemporary Political Economy" and prepared by Bülent Temel meets with the commitee's approval unanimously as dissertation in the field of Political Economics following the successful defense of the dissertation conducted on 03/12/2015.

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ÖZ

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Bu tez çalışması örgütsel rasyonelite ile bağlamlar arasındaki ilişkiyi çağdaş politik ekonomide bir istikrar unsuru olarak incelemektedir. Çalışmada tarihsel önemi olan Büyük Durgunluk (2007-09) krizinden hareketle üç analiz sunulmaktadır. İlk olarak örgütsel yapının açıklayıcı bir değişken olarak ele alınmayışı mevcut kriz yazınında bir eksiklik olarak belirlenmiştir. Ardından kooperatifçilik kuramının kavramsal çerçevesi kullanılarak örgütsel yapı ile istikrar arasındaki bağlantı öne sürülmüştür. İkinci analizde ticari ve kooperatif bankaların risk sağduyusu teşvik eden bağlamlar yaratma kapasiteleri Kanada finans sektörünün özelinde araştırılmıştır. Ticari ve kooperatif kuruluşların risk iştahları arasındaki farkları ampirik olarak incelemek üzere panel veri analizi tekniğinden faydalanılmıştır. Ampirik bulgular ticari rasyonelitenin kooperatif rasyoneliteye göre risk iştahıyla daha yakından ilintili olduğuna dair beklentiyi desteklemiştir. Tezin kapsamındakı üçüncü çalışmada kooperatiflerin performansının içinde bulundukları toplumsal, ekonomik, siyasi ve yasal bağlamlarla ilişkisi incelenmiştir. Kooperatifçilik yoğunluğunun en yüksek olduğu ülkeler arasında olmasına rağmen kooperatifçiliğin ulusal öneminin oldukça düşük olduğu Türkiye'de bu çelişkinin nedenlerini anlamak üzere ülkenin önde gelen kooperatifçilerinden dördü ile görüşmeler yapılmıştır. Uzmanların Türk kooperatifçiliğinin çektiği zorluklara dair görüşleri seçilmiş bir grup ülkedeki benzer çalışmaların bulgularıyla birlikte değerlendirilmiştir. İnceleme Türkiye'de yaşanan sıkıntıların diğer gelişmekte olan ülkelerde görülen sorunlarla paralel, gelişmiş ülkelerdeki sorunlardan ise ayrışır olduğuna işaret etmiştir. Çalışmaların bulguları birarada değerlendirildiğinde 21. Yüzyılda kooperatifçiliğe dair zorlu bir durum ortaya çıkmaktadır: kooperatifçiliğin kapitalist ekonomilerde –özellikle de küreselleşmenin etkisiyle gittikçe daha

istikrarsızlaşan gelişmekte olan ekonomilerde- belirgin bir istikrara katkı yapma kapasitesi varken, onun bu potansiyelini gerçekleştirmesi daha ziyade gelişmiş olan ülkelerde yerleşik olan destekleyici bağlamların varlığına bağlı gözükmektedir.

Anahtar sözcükler: Büyük Durgunluk, kredi birlikleri, ticari bankalar, kooperatifçilik, kurumsal iktisat.

ABSTRACT

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This dissertation examines the relationship between organizational rationality and context as a factor of stability in contemporary political economy. Motivated by the Great Recession (2007-09) as a recent crisis with historical significance, three analyses have been provided. Firstly, consideration of organizational structure as an explanatory variable in the recession is identified as a gap in the literature on the crisis. Conceptual framework of cooperative theory is used to argue for the link between organizational structure and stability. Secondly, capacities of commercial and cooperative banks in creating contexts to encourage risk prudence are explored in the particular of Canadian financial sector. A panel data analysis is employed to empirically identify the difference in risk appetites between commercial and cooperative organizations. Estimations support the expectation that commercial rationality is more closely associated with risk appetite than cooperative rationale is. In the third essay, the link between cooperative performance and social, economic, political and legal contexts in which cooperatives exist is examined. Four of the prominent cooperative experts in Turkey have been interviewed to explore the reasons why cooperativism lacks national significance in this country despite the fact that it has one of the highest concentrations of cooperatives in the world. Experts' opinions on cooperative challenges are reviewed against the findings from studies in a select group of countries. Challenges that confront Turkish cooperativism appear to be consistent with those found in other developing country studies, but diverge from those reported in developed countries. Findings point to a predicament about cooperativism in the 21st Century: cooperativism has an observable capacity to endorse stability in capitalist economies –especially in developing countries that are increasingly destabilized in the face of globalization; however its competence to fulfill this potential relies on the presence of conducive contexts that are more prevalent in already developed economies than the developing ones.

Keywords: Great Recession, credit unions, commercial banks, cooperativism, institutional economics.

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INTRODUCTION

Financial crisis that began in the U.S. mortgage sector in late 2007 has become the latest economic crisis with substantial consequences. Motivated by the colossal displacement caused by the crisis, this dissertation provides three related but independent essays to examine the potential of cooperative rationality in promoting economic stability. Chapter 1 provides a review of the literatures on financial crises in general and the 2007 crisis in particular in order to identify the room available to discuss cooperative organization as a structure conducive to organizational stability in financial sector. Chapter 2 examines the link between organizational structure (cooperative vs. commercial) and risk appetite in the case of Canadian banking. In Chapter 3, challenges faced by the cooperative movement in Turkey are analyzed in an effort to explore the role contexts play for cooperatives to fulfill their stability potential. While the three essays collectively shed light on cooperative rationality as a factor of economic stability, they are independent from one another in terms of their motivations, scopes, units of analysis, and methodologies. Remainder of the Introduction section provides more detailed descriptions of the essays, and their intended contributions.

CHAPTER 1. The first essay presents a discussion of the 2007 crisis, the *Great Recession*, as a historically significant recession that warrants critical examinations of contemporary political economy. The crisis started the longest period of high unemployment since the Great Depression (24 quarters to date), drove 12 million households to lose ownership of their homes, and left every seven American dependent on government's food stamps to satisfy basic grocery needs. Despite the largest quantitative easing in history ($3.5 trillion), real growth of output remains sluggish, unemployment rate is in two-digits, [1] consumer and business confidence are in historical lows, and national debt continues to soar in the United States today seven years into the

[1] In terms of *U6 unemployment rate*, which considers discouraged workers who quit looking for a job, and others who work on a part-time basis as "unemployed."

crisis. The chapter reviews the literature on the crisis, and the theoretical explanations of financial crises. While acknowledging the myriad of policy-relevant insights, it finds organizational rationality as an overlooked analytical angle. The chapter recognizes the prevalence of commercial purpose as the assumed motivation behind economic behavior in the literature, and underlines cooperative purpose as a conventional complement to it. Organizational structure is argued to influence contextual realities, to which organizations respond; and *cooperative* structure is presented as an organizational form that can potentially drive organizations towards higher stability by creating more risk-wary contexts. The chapter makes the case for cooperativism by exploring the distinguishing conceptual framework of the cooperativist theory, and its relationship to organizational contexts conducive to stability. It aims to add to the literature on financial stability by putting forth organizational structure as an analytical unit that merits examination for a thorough understanding of organizational stability.

CHAPTER 2. The second chapter presents an examination of the link between organizational rationality and risk propensity in the field of finance in Canada. Four primary balance sheet indicators of risk used by the Canadian Central Bank are blended into a Composite Managerial Risk Indicator (CMRI) as a stylized indicator of risk appetite in financial organizations. Organizations in the sector are classified in two categories as *commercial* (profit-maximizing) and *cooperative* (not-for-profit) *banks*[2]. Quarterly data (2000-2010) are gathered for the five largest commercial banks and the five largest cooperative banks, which represent over 90% of all assets in the sector. Quarterly CMRI figures of these organizations are taken as dependent variables, quarterly changes in M3 money supply and output are treated as macroeconomic independent variables, and quarterly changes in franchise values and stock values organization-level independent variables. Panel data analysis is performed to examine

[2] The term *cooperative bank* is used to refer to those financial institutions that are established as cooperatives. Also known as *credit unions* (and *caisses populaires* in French-speaking state of Quebec in Canada), these banks may be different from *cooperatives' banks*, which are (commercial or cooperative) banks established to serve the cooperative sector/social economy only.

the argued link between organizational attitude towards profits (profit maximizing vs. making) and risk appetite in the sector. The essay seeks to contribute to the literature on organizational stability with its introduction of CMRI as an aggregate indicator of managerial risk appetite, treatment of cooperative and commercial banks as distinct sets of financial institutions, and comparative analysis on their risk appetites as an examination of their stability attributable to their structures.

CHAPTER 3. The third essay examines practical instrumentality of the cooperative form as an endorsement for organizational (and consecutively, sectoral and economic) stability. Relationship between cooperatives and contexts is explored from the opposite angle than the previous chapter: How do cooperatives, which are found to provide a positive context for stability in Chapter 2, *respond* to different contexts as organizational entities? To examine this research question, the chapter explores the state of cooperativism in Turkey, a country with a high number, but low significance of cooperatives. Four prominent cooperative experts in Turkey are interviewed to compile the issues facing Turkish cooperativism today: Prof. Erkan Rehber who has chaired Uludağ University's agricultural economics department for 17 years, and has written extensively on Turkish cooperativism; Mrs. Leyla Özcan who is the director general of Turkish Cooperatives' Alliance –the largest association of cooperatives in Turkey, Mr. Murat Karayalçın who is the former Vice Prime Minister of Turkey (1994-1995) and the founding director of Kent-Koop (1981-1991) –arguably the most successful cooperative project in Turkey's centennial history; and Prof. Nurettin Parıltı of Gazi University Business School who presides the Organization of Turkish Cooperativism –a semi-public non-profit with an essential role in the history of Turkish cooperativism. Experts' opinions were retrieved along the lines of eight questions that address cooperatives' responses to various social, economic and political contexts. Cooperative challenges experts noted are reviewed against the findings from cooperative studies in a select group of countries in an effort to identify the extent to which these issues exist across developmental lines rather than country-specific factors. Findings add to the cooperatives literature the insight that cooperative challenges are shaped by development levels of the countries in which cooperatives operate, and accordingly, policymaking to revitalize cooperativism needs to address developmental issues in the larger society and economy in order to resolve the issues exclusive to cooperatives.

The essays employ different levels of abstraction. The first essay provides a criticism of the abstraction in the *homo oeconomicus* axiom in the literature on financial instability, and promotes a context-driven rationality as a thought process that better defines the core of organizational behavior. This approach builds on the heterodox assessments of neoclassical economics theory, which has conventionally resorted to wide applications of abstraction in its quest for universality in economic knowledge. In the second essay, a significantly lower degree of abstraction is used. A composite managerial risk indicator (CMRI) is conceptualized to represent organizational risk appetite in Canadian financial sector, and an econometric instrument is used with real data to examine the implication that cooperative organizational framework is associated with a more sober perception of risk in the particular of Canadian finance. The analysis consists of deductive reasoning, and supplies an inference applicable only to the observed sector. The third essay offers a generalized conceptualization of *cooperativism* as an outcome of its abstractive approach. It presents cooperativism as a uniform economic phenomenon, constituent elements of which are identical across sectors and economies. In order to provide an aggregated assessment of the contexts that influence cooperative behaviors around the world, the essay treats cooperative movements in select countries as similar entities irrespective of the composition of different types of cooperatives in each national cooperative movement.

CHAPTER 1

THE GREAT RECESSION (2007-2009) AND AN ALTERNATIVE INSTITUTIONALIST APPROACH TO FINANCIAL CRISES: ORGANIZATIONAL RATIONALE

This chapter is motivated by the second largest economic crisis the global economy had to endure in the last one hundred years. It presents an account of the Great Recession (2007-2009), its enormous scope, argued causes and potential consequences. Theoretical explanations of financial crises in general and empirical explanations of the subject recession in particular are reviewed in an effort to identify the space available for further exploration of the conditions that led to the meltdown in 2007.

The essay seeks to add to the scholarly examinations of the crisis by identifying an axiomatic challenge in them. Literature reviews suggest that a comprehensive set of studies with a diverse range of approaches provide policy-relevant insights into the conditions that preceded the crises, however they are invariably based on an assumption that *homo oeconomicus* axiom is the sole postulate that explains economic behavior. This chapter identifies this commonality towards a subsequent exploration of cooperative rationality as an alternative assumption. This essay is independent from the two analyses that follow it, however it lays the groundwork for them with its consideration of organizational rationale as a potentially explanatory variable in economic instability.

1.1 The Great Recession (2007-2009)

Subprime mortgage crisis that began in the U.S. housing market in 2007, and brought down various sectors of the economy within eighteen months has become the second most devastating economic event in the 237-year history of the United States.

The Great Recession[3] has left 23 million people unemployed,[4] 12 million people without their homes,[5] and 47.5 million people on food stamps[6] in the world's largest and most prosperous economy. A sixth of American workers have lost their jobs at least once between 2007 and 2009,[7] and 2014 will mark the longest period since the Great Depression (6 consecutive years) during which unemployment remained above 7.5%.[8] Although an unprecedented amount of quantitative easing ($3.5 trillion as of late 2014)[9] allowed the recession to appear to end in 2009,[10] the U.S. economy remains to have an unemployment rate of 12.4%[11] and an employment rate below its 1985 level (59%) in 2014.[12] Policymakers continue to be challenged with a level of consumer confidence that has dropped from 112% to 81% of the base year (1985)[13] and a debt stock that has risen from 66% to 103%[14] since 2007. Net worth of households and non-profit organizations remain below their pre-crisis levels while the median real income for a male worker is

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[3] While other terms such as *Subprime Mortgage Crisis*, *Financial Crisis of 2007–2008*, and *Great Correction* have also been used to refer to the crisis; *Great Recession* has become the most widely used term for it. http://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology/?_r=0.
[4] U6 unemployment rate in July 2012. Data: The Bureau of Labor Statistics, http://www.bls.gov/data/#unemployment
[5] "2011 Year-End Foreclosure Report: Foreclosures on the Retreat," last modified January 9, 2012, http://www.realtytrac.com/content/foreclosure-market-report/2011-%20year-end-foreclosure-market-report-6984
[6] The U.S. Department of Agriculture, Food and Nutrition Service. Available at http://www.fns.usda.gov/pd/29snapcurrpp.htm, accessed July 14, 2013.
[7] Henry S. Farber, "Job loss in the Great Recession: Historical perspective from the Displaced Workers Survey, 1984–2010," Working Paper 17040 (National Bureau of Economic Research, 2011), http://www.nber.org/papers/w17040.pdf (accessed August 02, 2014).
[8] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013–2023*, by Christina Hawley Anthony et al., 4649 (Washington, D.C.: United States Government Printing Office, 2013), 35.
[9] Congressional Research Service, *Monetary Policy and the Federal Reserve: Current Policy and Conditions*, by Marc Labonte, RL30354 (Washington, D.C.: United States Government Printing Office, 2014), 14.
[10] NBER report entitled "Business Cycle Dating Committee, National Bureau of Economic Research," available at http://www.nber.org/cycles/sept2010.html, accessed July 22, 2013.
[11] The U.S. Census Bureau, Labor Force Statistics from the Current Population Survey. Available at http://data.bls.gov/timeseries/LNS12300000, accessed July 14, 2013.
[12] The U.S. Bureau of Labor Statistics, Table A-15: Alternative measures of labor underutilization. Available at http://www.bls.gov/news.release/empsit.t15.htm, accessed July 31, 2014.
[13] The Conference Board, Consumer Confidence Survey: Press release on June 25, 2013. Available at http://www.conference-board.org/data/consumerconfidence.cfm, accessed July 14, 2013.
[14] David Wessel, "Did 'Great Recession' Live Up to the Name?" *The Wall Street Journal*, April 8, 2010.

below its level in 1968.[15] Total number of personal and business bankruptcies during the recession was 68% higher than the pre-crisis level,[16] and the number of homeless people rose by 47% since 2007.[17] Within four years following the beginning of the meltdown, a quarter of households have lost 75% or more of their total wealth while every other household has lost at least a quarter of the value in its assets.[18] House prices have plunged by about a third within three years after May 2006 across the U.S.[19] Social consequences of the crisis included dramatic increases in stress-related health conditions[20] and academic performance of children with laid-off parents[21], and a general drop in social cohesion in the society[22].

State of the U.S. economy over the course of the recession has motivated academic economists for reexamination of some of the most fundamental concepts and relationships, which has taken central stage in economic orthodoxy –as represented by the IMF.[23] The recession shattered the long-held belief that a *flexible labor market*

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[15] The U.S. Census Bureau, Historical Income Tables: People (Table P.5 Regions –People by Median Income and Sex: All Races). Available at http://www.census.gov/hhes/www/income/data/historical/people/2011/P05AR_2011.xls, accessed July 14, 2013.

[16] The U.S. Courts, Bankruptcy Statistics 12-Month Period Ending March (2013 vs. 2007). Available at http://www.uscourts.gov/Statistics/BankruptcyStatistics/12-month-period-ending-march.aspx, accessed July 14, 2013.

[17] The National Alliance to End Homelessness and Homelessness Research Institute, The State of Homelessness in America 2013. Available at http://b.3cdn.net/naeh/bb34a7e4cd84ee985c_3vm6r7cjh.pdf, accessed July 14, 2013.

[18] Fabian T. Pfeffer, Sheldon H. Danziger, and Robert F. Schoeni, “Wealth Disparities Before and After the Great Recession,” *The Annals of the American Academy of Political and Social Science* 650 (2013): 98.

[19] David B. Grusky, Bruce Western, and Christopher Wimer, "The Consequences of the Great Recession," in *The Great Recession*, ed. David B. Grusky, Bruce Western, and Christopher Wimer. (New York: Russell Sage, 2011). 4.

[20] Sarah A. Burgard, Jennie E. Brand and James S. House, “Toward a better estimation of the effect of job loss on health,” *Journal of Health and Social Behavior* 48 (2007): 380-1.

[21] Ann Huff Stevens and Jessamyn Schaller, “Short-run effects of parental job loss on children's academic achievement,” *Economics of Education Review* 30 (2011): 298.

[22] Paola Giuliano and Antonio Spilimbergo, “Growing Up in a Recession,” *Review of Economic Studies* 81 (2014): 813-5.

[23] Cornel Ban and Kevin Gallagher, “Recalibrating Policy Orthodoxy: The IMF since the Great Recession,” *Governance* Special issue (2014): 1-20.

would be the answer to sluggish growth and rising unemployment.[24] Prior to 2007, reducing labor laws to support investments and job-creation had been a feature that had distinguished Anglo-American approach from the continental European one in economics.[25] International organizations such as the OECD, IMF and World Bank consistently advocated labor deregulations[26] as academic orthodoxy systematically vouched for the virtues of flexible labor markets.[27] After the crisis in 2007, trajectories of output and employment in the economy have diverged too substantially for this position to continue to be endorsed credibly. From the (declared) ending of the recession in late 2009 until 2012, employment in the U.S. has barely increased (1.2%) despite the fact that the GDP has grown by 7.5%. While 3% of jobs were lost on average during the recessions since the mid-19th Century, the recent crisis destroyed 6.3% of jobs in the U.S. economy where the labor market has been highly flexible (unregulated) and policymakers increased money supply by historic amounts as a remedy. *Rational expectations* and *dynamic stochastic general equilibrium model* (DSGEM) are two other concepts that have come under closer scrutiny in the wake of the crisis.[28] Massive loan defaults that have occurred during the crisis refuted the faith in market-driven values determined out of the rational expectations paradigm. It became visible that pricing mechanism that is shaped solely by market participants does not necessarily generate correct values that correspond to real risk levels for financial commodities. As the mortgage interest rates and the default risks of their underlying debt obligations did not overlap, John M. Keynes and Friedrich von Hayek's dated calls for a more complex

[24] Richard B. Freeman, *America Works: Critical Thoughts on the Exceptional U.S. Labor Market* (New York: Russell Sage Foundation, 2008) as cited in Sheldon Danziger, "Evaluating the Effects of the Great Recession," *The Annals of the American Academy of Political and Social Science* 650 (2013): 12-3.
[25] Japanese Ministry of Economy, Trade and Industry, "White Paper on International Trade 2002: East Asian Development and Japan's Course," Facilitation of industrial structural adjustment, http://www.meti.go.jp/english/report/downloadfiles/gIT0231e.pdf (accessed January 02, 2015).
[26] The OECD. "OECD Jobs Study: Facts, Analysis and Strategies." Accessed August 17, 2014. http://www.oecd.org/employment/emp/1941679.pdf.
[27] Richard Freeman, "Labour market institutions without blinders: The debate over flexibility and labour market performance," *International Economic Journal* 19 (2005): 129.
[28] Paul Ormerod, "The Current Crisis and the Culpability of Macroeconomic Theory," *Twenty-First Century Society* 5 (2010): 5-18.

assumption for rationality[29] resurfaced to relevance. Rapid contagion of deadlock from one sector of the economy to another during the crisis further unveiled the fragility of the DSGEM. Transmission mechanism, which facilitates multiple equilibriums across various segments of the economy in the model, appeared to spread not only equilibriums, but also gridlocks in the economy. Involvement of a distressed financial sector exacerbates this condition as deceleration in lending translates into contraction in real production."[30]

1.2 Literature Review

Financial crises are "episodes of financial-market volatility marked by significant problems of illiquidity and insolvency among financial-market participants and/or by official intervention to contain such consequences."[31] There are four main types of financial crises: *banking crises*, *currency crises*, *debt crises* and *market crashes*. *Banking crises* are "financial distress resulting in the erosion of most or all of aggregate banking system capital" while *currency crises* consist of a "forced change in parity, abandonment of a pegged exchange rate, or an international rescue."[32] A *debt crisis* is "nonpayment of pre-agreed debt service"[33] faced by sovereign states or private economic actors. In its narrower definition, it refers to "[…] a default or [… a condition where] secondary-market bond spreads are higher than a critical threshold."[34] Finally, a

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[29] Von Hayek emphasized divergence of collective outcomes from the common spirit of individual choices that generate them while Keynes challenged the calculative deductive logic in mainstream economics with an observation that information exists much less certainly in practice than assumed in theory.
[30] Ibid., p. 17.
[31] Michael Bordo, Barry Eichengreen, Daniela Klingebiel, Maria Soledad Martinez-Peria, "Is the crisis problem growing more severe?" *Economic Policy* 16 (2001): 55.
[32] Ibid.
[33] Andrea Pescatori and Amadou N. R. Sy, "Are Debt Crises Adequately Defined?" *IMF Staff Papers* 54 (2007): 308.
[34] Ibid., p. 328.

market crash is defined as a substantial and sudden drop in the "discounted expected returns of holding assets for a period" in a market.[35]

Financial crises occurred repeatedly since the rise of industrial capitalism in the mid-18th Century.[36] In the 1760s, Dutch banker Leendert de Neufville's inability to meet his obligations from a new instrument (*wisselruiterij*, meaning cavalry) shattered the public trust in the financial sector, and led to the first known financial crisis in history.[37] The crisis was followed by the Credit Crisis of 1772-1773, which was precipitated by the Scottish banker Alexander Fordyce's defection to France to avoid paying returns to his depositors, and the subsequent bank runs of massive scale. By the end of the century, two other crises occurred in England and the United States; and over the course of the 19th Century, 12 crises occurred mostly in Northern Europe, Australia and the U.S. Next century had 15 financial crises including the Great Depression of 1929-1939, which is the most devastating economic event in history in terms of severity, scope and duration. In the first 14 years of the 21st Century alone, there have been 11 financial crises, and these crises were dispersed to countries as diverse as Uruguay, Iceland, Turkey, Ukraine and Venezuela.

1.2.1 Literature on Financial Crises

Theoretical explanations of financial crises emphasize the roles played by four main forces: social psychology/mass hysteria, liquidity shortages, overvaluations in markets, interdependence of economic actors, and inherent malfunctions in capitalism. Tille and Bacchetta point out that financial crises are created by depositors' spontaneous panic in response to each other's changing attitude towards the safety of financial

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[35] John C. Williams, "Bubbles Tomorrow and Bubbles Yesterday, but Never Bubbles Today?" *Business Economics* 48 (2013): 225.

[36] Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton, NJ: Princeton University Press, 2011).

[37] Tulip Mania of 1636-1637 and the South Sea Bubble of 1711 are two earlier episodes of crises; however they were not *financial* crises that have paralyzed financial sectors in their respective economies.

institutions.[38] When perceived negative prospects for an economy form at a period of real productive contraction, depositors can interpret it as financial institutions' compromised ability to meet their obligations, and make mass withdrawals.[39] As maturity risk, to which financial institutions are inherently exposed, turns out to be underestimated; financial sector would be vulnerable against formidable stress. [40]

Chari & Jagannathan observe that inherent informational asymmetry in the financial sector plays a major role in this counterproductive process.[41] Because depositors have no real information about each other's motivations, they are inclined to underestimate the likelihood that withdrawals are made for regular consumption purposes in times of sectoral stress. This underestimation leads to misinterpretation of withdrawals as a bank run, which precipitates an actual bank run by encouraging observant depositors to withdraw.

A second group of analysts perceives financial crises as products of liquidity shortages in banking sector. Of these scholars, Friedman and Schwartz highlighted the role played by changes in money supply as a result of consumer panics.[42] Financial institutions that feel vulnerable against mass withdrawals demonstrate a higher propensity to stock cash significantly above the legally required limits. Distressed banks balance out the rise in their precautionary liquidity with corresponding drops in the value of productive assets in an effort to restore their reserves back to the optimal level. While providing protection against potential liquidity shocks in the system, this move results in

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[38] Cédric Tille and Philippe Bacchetta, "Self-fulfilling risk panics," *American Economic Review* 102 (2012): 3674-700.
[39] Charles Jacklin and Sudipto Bhattacharya, "Distinguishing panics and information-based bank runs: welfare and policy implications," *Journal of Political Economy* 96 (1988): 568–92.
[40] Gary Gorton, "Banking panics and business cycles," *Oxford Economic Papers* 40 (1988): 751–81.
[41] Douglas Diamond and Philip Dybvig, "Bank runs, deposit insurance, and liquidity," *Journal of Political Economy* 91 (1983): 401–19.
[42] Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States: 1867-1960* (Princeton, NJ: Princeton University Press, 1963).

a deterioration of their profitability, which collectively, jeopardizes stability in the entire financial sector.

For Bhattacharya and Gale, financial crises are crises of liquidity shortage in financial sector.[43] They argue that financial institutions are intrinsically inclined to operate with low liquidity, and combined with the regulatory hardships in determining liquidity of bank assets in a timely matter, this tendency exposes the financial system to liquidity challenges on a continuous basis. Banks have a preference for illiquid assets that typically yield higher returns than liquid assets partly because of their lower level of cash convertibility. When they face mass deposit withdrawals within a short time frame, they restore their liquidity by borrowing from other banks in the domestic economy as well as abroad. While the interbank credit market allows individual banks to cope with short-run liquidity challenges, it also creates a moral hazard by incentivizing them to free ride on this pool of available funds rather than maintaining their own liquidity –a more costly option due to its higher opportunity costs. The use of assets other than fiat money makes it very difficult for Central Banks to monitor the true liquidity of bank assets. Accordingly, reserve requirements that legally mandate financial institutions to maintain a certain percentage of their assets in liquid form are a necessity in combating the illiquidity tendency that makes the financial sector prone to illiquidity-driven crises.[44]

As Freixas et al. point out, interbank system could also create systemic failures due to competitive motivations of the actors involved in it.[45] When individual banks are threatened by liquidity shortages, their competitors that have excess liquidity could use it as a competitive advantage to increase their market share. Because information about

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[43] Sudipto Bhattacharya and Douglas Gale, “Preference shocks, liquidity and central bank policy,” in *New Approaches to Monetary Economics*, ed. Wiliam A. Barnett and Kenneth J. Singleton (Cambridge/New York: Cambridge University Press, 1987), 69–88.
[44] Ibid., p. 87.
[45] Xavier Freixas, Bruno Parigi and Jean-Charles Rochet, “Systemic Risk, Interbank Relations and Liquidity Provision by the Central Bank,” *Journal of Money, Credit and Banking* 32 (2000): 625.

bank holdings are distributed in the market asymmetrically, liquid competitors could gain monopolistic power and strategically provide limited amounts of liquidity in order to compel their distressed competitors to sell their assets prematurely –before gains from them are fully realized. To ameliorate these inefficiencies, central banks must take an active role, and act as a lender of last resort.[46]

Diamond and Rajan point out that banks can also create liquidity crises by opting out of liquidating their illiquid assets in times of depressed asset values.[47] When a financial institution holds substantial amounts of assets for which there are few buyers (such as mortgage-backed securities in a depressed mortgage market), it has to satisfy its future needs for liquidity by fire sales –selling the assets for prices that are significantly below their face values. While they resolve the bank's immediate liquidity problem in the future, fire sales may decrease the values of the bank's other assets to a low level that could compromise its solvency. It may lead to a panic among the bank's depositors as a few frequent withdraws could create a hysteria among other depositors, and a system-wide crisis.

Gale and Yorulmazer acknowledge a unique feature of the financial sector as a potential cause for stress in it.[48] Unlike most other sectors, finance is a line of business in which competition and cooperation among the competitors coexist. Banks rely on each other's funds in their competition against them. When adverse conditions prevail (actually or expectedly) in the financial sector, banks with a favorable coverage on liquidity could perceive the counterparty risk to be too high to justify providing liquidity to the interbank system. Moreover, they may fear that their access to favorable loans will be compromised in the future due to information asymmetry in the sector. They may

[46] Viral Acharya, Denis Gromb and Tanju Yorulmazer, "Imperfect Competition in the Interbank Market for Liquidity as a Rationale for Central Banking?" *American Economic Journal* 4 (2012): 184-217.
[47] Douglas W. Diamond and Raghuram G. Rajan, "Fear of Fire Sales, Illiquidity Seeking, and Credit Freezes," *Quarterly Journal of Economics* 126 (2011): 557-91.
[48] Douglas Gale and Tanju Yorulmazer, "Liquidity hoarding," *Theoretical Economics* 8 (2013): 291–324.

avoid providing liquidity to the interbank market out of an opportunistic motivation to use the current liquidity for future acquisitions of illiquid assets whose values would decline in response to a current rise in the future liquidity demand. *Liquidity hoarding* behavior creates disruptions in interbank lending and magnifies the liquidity problem in the sector potentially to levels of a crisis.

A third line of inquiry into the causes of financial crises focuses on overvaluations in asset prices. Allen et al. note that overvaluations driven by international capital mobility pave the way for both banking and currency crises.[49] In an international economic order, in which capital movement are unrestricted, stress in one economy results in misbalances in global money supply creating lending conditions that endorse asset overvaluation. Because controlling asset valuations is a politically sensitive move, valuations due to credit expansions often curb policymaker's willingness for active macroeconomic management –allowing the stress in financial sector to grow further.[50]

Increased composition of real estate assets in bank portfolios accelerates the overall risk in financial sector.[51] Unlike other sectors, real estate sector is one in which cycles are experienced more dramatically. Expansion of available credit in the financial system allows a parallel expansion of purchases in the housing market, which drives real estate values up. Higher values translate into higher subjective collateral values of real estate for financial institutions, which distort financial institutions' estimation of the risk level in real estate market. Authors explain this distortion with *disaster myopia* and *perverse incentives*. Disaster myopia refers to a bank's propensity to underestimate risks

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[49] Franklin Allen, Ana Babus and Elena Carletti, "Financial Crises: Theory and Evidence," *Annual Review of Financial Economics* 1 (2009): 97–116.
[50] Carmen M. Reinhart and Kenneth S. Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton, NJ: Princeton University Press, 2011), 1.
[51] Richard Herring and Susan Wachter, "Bubbles in real estate markets," in *Asset Price Bubbles: The Implications for Monetary, Regulatory, and International Policies*, ed. William C. Hunter, George G. Kaufman and Michael Pomerleano (Cambridge, MA: MIT Press, 2003), 217-29.

in the real estate market due to the fact that drastic changes in real estate prices are observed less frequently.[52] Because econometricians and statisticians cannot use data to predict real estate crashes, they rely on subjective evaluations, which is vulnerable against the bias called *availability heuristic*.[53] This condition refers to the tendency of the human mind towards perceiving frequently and/or recently experienced events to be more likely to occur in the future. Because real estate crashes have low frequency, banks' risk evaluators tend to underestimate the prospects for a meltdown in the housing market.

Disaster myopia paves the way for a number of perverse incentives that increase the risks in the real estate market. Banks that have underestimated the true risks of real estate lending could relax its lending standards in order to protect their market shares against their competitors. Looser collateral requirements and higher loan-to-value ratios would allow developers to operate with higher leverage. When a large fraction of a real estate investment is funded by bank credits, investors would not have an incentive to rescue a project that is near failure, because the costs of failure would be disproportionately allocated between him/her and his/her creditor. Other perverse incentives impact depositors and banks in a sequential fashion. Social safety programs like the Federal Deposit Insurance, which guarantees public protection of bank deposits (up to $250,000 per bank account) in case of a bank failure, may eliminate the motivation for depositors to monitor the soundness of their banks' lending practices. When depositors remain indifferent to risk levels of their banks' investments, they do not demand higher returns from their deposits. This gap between the actual risks and expected returns provide an opportunity for banks to substitute their safer assets with riskier ones in an effort to improve their shareholder values. Outcome is a financial system that is heavily exposed to the instability of a volatile real estate market.

[52] Ibid., p. 221.
[53] Ibid., p. 223.

Park and Dornbusch exemplify the perception of financial crises as products of dynamics that facilitate the spread of organizational stress to the entire financial sector, economy or other economies.[54] As Allen and Gale concur, insufficient credit networks are a leading one of these facilitative dynamics. Interbank borrowing system allows financial institutions to hedge the liquidity risk they individually face. However, while performing an essential function in allocating resources across the sector, the system provides a perverse incentive for banks to shift liquidity burden onto competition,[55] which drives the economy into crisis when banks' exposures to a liquidity shock coincide with volatility in asset prices in the economy.[56] Because the interbank system is an incomplete system, in which the participating actors do not hold a single asset; any liquidity demand from one participant leads to a reallocation of asset portfolios in the participant that provides the liquidity. Rapid changes in asset prices distort the manageability of this process as the liquidity providing bank has to execute this reallocation in a way that is too frequent and unpredictable. Accordingly, risk exposure of the entire financial system rises potentially to a level that compromises the integrity of the system. As Cifuentes et al. point out, "for this combination of shock and price elasticity, there is a nonmonotonic relationship between the number of interlinkages and the liquidity threshold. Contagion is small either when there are no interconnections, or when every bank is connected to every other bank (so that shocks are diffused evenly). Contagion is worst when there are moderately many interconnections."[57]

Financial contagion is a rational reaction in a sector with information asymmetry. When collecting information about investment alternatives is costly, investment decisions of major actors in the system signals the entire system for investment

[54] Yung Chul Park and Rudiger Dornbusch, "Contagion: understanding how it spreads," *World Bank Research Observer* 15 (2000): 177-97.
[55] Franklin Allen and Douglas Gale, "Financial contagion," *The Journal of Political Economy* 108 (2000):1-33.
[56] Rodrigo Cifuentes, Gianluigi Ferrucci and Hyun Song Shin, "Liquidity risk and contagion," *Journal of the European Economic Association*, 3 (2005): 556-66.
[57] Ibid., p. 564.

worthiness of the available options. As followers mimic the leaders' actions, especially in unloading holdings from particular options, the herding behavior they display results in a magnification of the liquidity challenge abandoned options face. Contagion could spread from one particular investment option to all others that are within the same class also by the leading actors in the system. According to this *wake-up call hypothesis*, investors would be motivated to withdraw from all identical investment destinations upon experiencing a failure in one of them only. Investment risks blowing in one area lowers the risk appetite in all similar areas, which increases the scope of the crisis from an individual stress to a regional one.

Kindleberger and Aliber's account of instability is attached the absence of an international lender of last resort in a globalized economic system.[58] They note that free international mobility of capital causes rapid depreciation of domestic currency and increases in national debt burden denominated in foreign currencies when international capital's attention shifts away from an economy to which it had been invested. To alleviate the potential destruction that would follow the financial crises in response to this context, organizations such as the IMF must provide loans to reduce the extent of this undershooting. International organizations' failures in thoroughly fulfilling their mission in warning member countries about unsustainable levels of international capital inflows and providing funds to remedy later outflows have allowed financial crises to spread globally over the 20th Century.

Core economies' reluctance to create international portfolios denominated in peripheral economies' currencies is a destabilizing factor that keeps developing economies exposed to crises.[59] Even developing economies that have strong institutions

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[58] Charles P. Kindleberger and Robert Z. Aliber, *Manias, Panics, and Crashes: A History of Financial Crises* (Hoboken, NJ: John Wiley & Sons, 2005): 293.
[59] Barry Eichengreen and Ricardo Hausmann, "Exchange Rates and Financial Fragility," in *New Challenges for Monetary Policy*, Federal Reserve Bank of Kansas City (Kansas City, MO: Federal Reserve Bank of Kansas City, 1999): 329-68.

and macroeconomic policymaking (such as Singapore and Chile) are typically incapable of selling debt obligations denominated in their own currencies –a challenge that is even more pronounced for smaller economies. Subsequently, their debt stock remains vulnerable against the exchange rate risk, which increases even further with the global concentration of reserve currencies in five main currencies –the U.S. dollar, euro, yen, sterling and Swiss franc. As the East Asian banking crisis in the 1990s demonstrated, financial crises in developing economies have the potential to spread to other economies as the contagion effect compromises real production globally.

Another set of observers consider financial crises as an inherent feature of capitalism as an economic system. In his celebrated critique, Marx argued that capitalism harbors an organic dynamic that consistently drives the economy into crises. In the *theory of the tendency of profit rates to fall*, he explained that competition in a capitalist economy would constantly press capitalists to reinvest a significant portion of surplus value they extract from the labor. Over time, the ratio of *constant capital* (machinary) to *variable capital* (labor) increases. When the increase in this ratio (which Marx called the *organic composition of capital*) occurs faster than the increase in the profits per worker (the *ratio of surplus value*), and counterveiling dynamics such as productivity improvements or increased international trade cannot challenge this dynamic substantially; then corporate profitabilities decline. Falls in profitability compel businesses to decrease or halt production, which decreases the stock of constant and variable capital in productive economy. Rising unemployment (or *the reserve army of labor*, as Marx called it) causes wages to decline, which eventually restores corporate profitability at a new equilibrium. This circular movement spells the prevalence of business cycles in capitalist economies –making crises a constant feature of capitalism.[60]

Minsky concurred with the proposition that financial instability is an inherent feature of capitalist expansion, if with a different explanation and remedy. He argued

[60] Stuart Easterling, "Marx's theory of economic crisis," *International Socialist Review* 32 (2003): 32-59.

that periods of increases in asset values encourage increases in the share of speculative leveraging among investors in the economy. Positive outlook creates an illusion that increasing profitability is attached to a lower level of risk than before. Subsequently, economic actors rely less on *hedge financing* (lower-risk debt that can be paid back by the cash flow from the investments for which it was taken), and more on *speculative* (medium-risk debt whose only interests are serviced by cash flows from relevant investments) and *Ponzi financing* (debt unsecured by investment returns). Once the share of unsecured liabilities reach a certain level in debt portfolios in the economy, loan repayments are compromised and loan default risk increases. Subsequent decreases in lending appettite and increases in interest rates result in counterproductive falls in lending volume in the industry. As financial sector stops to facilitate the use of savings for investments in the economy, recessionary conditions set in, and financial sector that is challenged by widespread defaults faces an additional threat due to the fall in business volume. Unlike Marx who advocated for the abolishment of the capitalist system that produces the class relations behind constant crises, Minsky argued that prudent regulations of the financial system would alleviate, if not eliminate, the likelihood of crises in capitalism.[61]

Nitzan and Bichler find capitalists to be as responsible from crises as capitalism that produces capitalists is. They contend that the capitalist class pursues relative rather than absolute power, because “the driving force of capitalism is not economic growth and the accumulation of productive machines and structures, [...] but the differential accumulation of capitalized power.”[62] Financial crises redistribute the national income share to the favor of the capitalist class, which provides the incentive to sustain those conditions to further their differential power in the society. Rajan and Singales add that

[61] Minsky, Hyman P. “Sources of Financial Fragility: Financial Factors in the Economics of Capitalism,” Hyman P. Minsky Archive Paper No. 69, 1995. http://digitalcommons.bard.edu/hm_archive/69, accessed October 2014.
[62] Jonthan Nitzan and Shimshon Bichler, “Can Capitalists Afford Recovery? Three Views on Economic Policy in Times of Crisis,” *Review of Capital as Power* 1 (2014): 148.

concentration of productive capacity would motivate the incumbent actors in the economy to suppress and overwhelm the very free market process that facilitated their rise to prominence.[63] Subsequently, compromised economic opportunities and competitive dynamics drive the financial system to a halt, and financial stresses occur.

These systemic criticisms are consistent with that of Stiglitz and Weiss who observe that profit maximization motive in capitalism organically create conditions for credit rationing –applying downward pressure on financial intermediation.[64] Motivated to improve their profitability, financial institutions are inclined to favor borrowers that accept higher interest rates. Because they do not fully possess the true potential and risks of the investments for which the loans are sought, banks operate with constant exposure to adverse selection. When borrowers who are least likely to pay back their loans constitute a larger portion of the banks' loan portfolios, banks reduce their supply of high-interest loans in order to contain their overall risk exposure without compromising profitability. This tendency constitutes an unnatural interference with the market whose distortion becomes visible when interest rates rise in response to market dynamics or monetary policies. Increased rates cause the stock of unsatisfied credit demand to grow even larger instead of pulling down the credit demand as it would be expected. As credit market does not settle in a new equilibrium, interest rates remain high and investments and productivity remain low. Recessionary gap translates into loan defaults by unproductive businesses, and banks whose portfolios comprise mostly of risky high-interest loans resort to credit rationing. Recessionary conditions spread wider due to financial sector's failure to channel excess capital to productive purposes.

1.2.2 Literature on the Great Recession

[63] Raghuram Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists* (Princeton, NJ: Princeton University Press, 2004).
[64] Joseph Stiglitz and Andrew Weiss, "Credit Rationing in Markets with Imperfect Information," *American Economic Review* 71 (1981): 393-410.

As other major episodes of financial sector failure in economic history, the Great Recession of 2007-2009, which has become the second most devastating crisis over the last hundred years, led to a substantial research literature. Within five years following the official ending of the recession in 2009; 7,977 journal articles, 1,005 books and 789 dissertations or theses related to the recession have been published.[65] A content analysis on Financial Times found that *systemic risk* (including the subjects of moral hazard, deregulations and executive compensations) was the most frequently addressed issue in the newspaper in 2008 –replacing *financial innovation*, which was the topic in 45% of the articles in 2007.[66] Academic literature on the recession sheds light on the roles played by a dysfunctional political order, erroneous assumptions in neoclassical orthodoxy, disequilibria in various segments of the economy, psychological factors, and inherent crisis-susceptibility of capitalism.

Political economic readings of the recession trace the foundations of the meltdown to a wave of financial deregulations carried out by a political establishment whose public purpose has significantly corroded since the early 1980s. Kaiser observes that, in the wake of a prosperous era after the WWII and the following Cold War, corporate elites in the U.S. have dedicated increasing amounts of funds in the political sphere in order to influence policymaking.[67] Corporate influence on the political system was legitimized as a form of *freedom of expression* –the argument that corporations are tax-paying "citizens" that deserved to be heard in politics, and legalized via the practices of *paid lobbying* and *campaign contributions*. $30 billion was spent on lobbying alone

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[65] Total number of publications that include the term "Great Recession" as listed in LSE Summons/ProQuest search engine on August 22, 2014. These figures are major increases from the five year period following the Great Depression in 1939, during which 47 journal articles, 243 books and 7 dissertation or theses were published. While the facts that publication opportunities differed vastly between the two periods, and that different terms such as "Financial Crisis of 2007-2009," "Great Correction," "Global Recession of 2009," and "Subprime Mortgage Crisis" were also used to refer to the recent crisis disallow a perfect comparison; the vast disproportion of the literatures across the two periods point to the scope of contributions in the aftermath of the Great Recession.
[66] Emily Rose Kiona Crubaugh, "Economic Theory and Financial Crisis: A Systemic Analysis of the Financial Times" (B.A. thesis, Brown University, 2011).
[67] Robert G. Kaiser, *So Damn Much Money: The Triumph of Lobbying and the Corrosion of American Government* (New York: Random House, 2010).

between 1998 and 2010, and the financial sector (including insurance and real estate subsectors) was the largest spender with an estimated $4.3 billion it spent on lobbying functions[68] and $3.4 billion it spent on federal elections over the decade that preceded the crisis.[69] As it became an accepted political norm for special interest groups to pressure elected officials for supporting policies favorable to their narrow interests, policymakers have responded to corporate demands positively in order to get reelected and sustain their privileges after their government careers. As Rodrik puts, "Politicians became income-maximizing suppliers of policy favors, citizens became rent-seeking lobbies and special interests; and political systems became marketplaces in which votes and political influence are traded for economic benefits."[70] Schepers concurs: "[…] the rapid growth of lobbying is related not just to the emergence of new rule-making institutions, but also to the neo-liberal (or neo-classical) free market theories and to the dominant focus on shareholder interest, which created or deepened the dichotomy between the market and the public interest. This forced managers to seek profit maximisation in the short term, and thus the costs which new regulation often imposes, however useful it may be in the long term, are to be avoided, regardless of the public interest."[71] Former Presidential candidate Sen. John McCain of the Republican Party describes this political culture as "an elaborate influence-peddling scheme, in which both parties conspire to stay in office by selling the country to the highest bidder."[72] Today, public trust in government remains at an historic low[73] as 66% of Americans

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[68] Jeffrey Sachs, *The Price of Civilization: Reawakening American Virtue and Prosperity* (New York: Random House, 2011), 112.

[69] Robert Weissman and James Donahue, *Sold out: how Wall Street and Washington betrayed America* (CA: Wall Street Watch, 2009) cited in James Crotty, "Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture'," *Cambridge Journal of Economics* no. 33 (2009): 563-580.

[70] Dani Rodrik, February 8, 2013, "The Tyranny of Political Economy," *Project Syndicate*, February 08, 2013, http://www.project-syndicate.org/commentary/how-economists-killed-policy-analysis-by-dani-rodrik.

[71] Stefan Schepers, "Business-government relations: beyond lobbying," *Corporate Governance* 10 (2010): 475.

[72] Ronnie Dugger, "Crimes Against Democracy," *The Progressive Populist* 5, no. 13 (1999): 14.

[73] Pew Research Center for the People & the Press, "Public Trust in Government: 1958-2013," last modified October 18, 2013, http://www.people-press.org/2013/10/18/trust-in-government-interactive/.

believe that plutocratic interests would continue to shape the U.S. policymaking irrespective what new laws may be adopted by the legislative branch.[74]

Increasing scope of lobbying and election funding activities facilitated the pro-corporate, supply-side vision of economics to penetrate into the political culture in the United States. Policymakers have consistently submitted to a conviction that considered regulations as counterproductive hindrances to prosperity. All five elected leaderships beginning with the Presidency of Ronald Reagan (1981-1989) have embraced policies towards deregulating various sectors of the U.S. economy –primarily, finance and transportation. Taxpayer Relief Act of 1997 gave sizeable biennial exemptions for homeowners ($500,000 for married couples, and $250,000 for unmarried individuals), and dramatically increased real estate's attraction as home ownership became the only investment that was exempt from capital gains taxes. Considered as a positive step towards helping the public realize the "American dream" of home ownership, the law served short-term electoral interests of the incumbent leaderships at the time, but led to a housing boom that crushed the economy later on.

The Garn-St. Germain Depository Institutions Act of 1982 repealed the prohibition on lending institutions to offer any mortgage loan other than the conventional fixed-rate mortgages. This legislation led to the creation of a number of "innovative" financial instruments such as *adjustable-rate mortgages* that offer a fixed rate initially and the market later on, *option ARMs* that offer initial teaser rates to be followed by larger payments, *interest-only mortgages* that allow payments for only interest for the first few years, and *balloon mortgages* whose payment schedule resembles the shape of a balloon. Todd points out that, in the absence of any effective regulations on their use, these instruments have become tools of predatory lending in the hands of financiers who have compelled financially-illiterate public to underestimate

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[74] Stephen L. Elkin, "Citizen and City," in *Dilemma's of Scale in America's Federal Democracy*, ed. Martha K. Derthick (New York, Cambridge University Press, 1999), 59.

their real debt burden, and to purchase homes and mortgages beyond their means.[75] McCoy adds that the crash in 2008 revealed the need for a "[…] dedicated consumer regulator charged with consumer protection [to] establish uniform standards and enforcement for all lenders."[76]

Gramm-Leach-Bliley Act of 1999 (GLBA) repealed the Glass-Steagall Act of 1933, which had prohibited commercial banks from involving in investment banking activities. It effectively eliminated the separation of commercial banking that relies on lending deposits as loans, and investment banking, which is the business of underwriting initial public offerings. Kuttner argues that the law "re-enact[ed] the same kinds of structural conflicts of interest that were endemic in the 1920s –lending to speculators, packaging and securitizing credits and then selling them off, [...] and extracting fees at every step along the way."[77] Weissman acknowledges the "change [in] the culture of commercial banking to emulate Wall Street's high-risk speculative betting approach" as the "most important effect" of the GLBA.[78] Thornton and Ekelund argue that GLBA would be sensible "in a world regulated by a gold standard, 100% reserve banking, and no FDIC deposit insurance," but in a fiat monetary system, it "amounts to corporate welfare for financial institutions and a moral hazard that will make taxpayers pay dearly."[79]

Commodity Futures Modernization Act of 2000 discontinued restrictions on trading in derivatives, mortgage debt obligations and credit-default swaps. The bill *de*

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[75] Richard M. Todd, "Financial Literacy Education: A Potential Tool for Reducing Predatory Lending?" *The Region* 16 (2002): 34.
[76] Patricia A. McCoy, "Federal Preemption, Regulatory Failure and the Race To the Bottom in U.S. Mortgage Lending Standards," in *The Panic of 2008: Causes, Consequences and Implications for Reform,* ed.s Lawrence E. Mitchell and Arthur E. Wilmarth, Jr. (Cheltenham, UK: Edward Elgar Press, 2010), 133.
[77] Robert Kuttner, "The Alarming Parallels Between 1929 and 2007," *The American Prospect*, October 2, 2007, accessed February 17, 2013. http://prospect.org/article/alarming-parallels-between-1929-and-2007
[78] Robert Weissman, November 12, 2009, "Reflections on Glass-Steagall and Maniacal Deregulation," *Commondreams website*, December 11, 2012, https://www.commondreams.org/view/2009/11/12-8
[79] Robert Ekelund and Mark Thornton, "More Awful Truths About Republicans," *Ludwig von Misses Institute website*, http://mises.org/daily/3098

facto facilitated fraudulent activities in financial sector by legalizing issuance of complex financial instruments that could conceal toxic assets.[80] Crotty argues that this bill's legislation exemplifies the principal-agent problem in a commercialized political system: "[…] appointed officials in the Treasury Department, the SEC, the Federal Reserve System and other agencies responsible for financial market oversight are often former employees of large financial institutions who return to their firms or lobby for them after their time in office ends."[81] Then-President Bill Clinton signed the Commodity Futures Modernization Act in late 2000 within his last few weeks in the office. Shortly after he signed the bill that provided enormous benefits to financial institutions, and stepped down; Clinton received $125,000 first from Morgan Stanley and then from Credit Suisse to deliver speeches in these companies. Clinton has confirmed his lucrative post-Presidency career, which had provided him $65 million in nine years: "I never had money until I got out of the White House, [...], but I have done reasonably well since then."[82]

Tarr stresses that policymakers who sought to accelerate home ownership in the U.S. have consistently chosen policies that promised better electoral returns for themselves in the short-run, but jeopardized macroeconomic stability in the long run.[83] Policy choice between lowering lending standards and subsidizing down payments was a case in point. While both policies would help with the eventual goal of increased home ownership, subsidies impose a budgetary constraint, which would empower the opposition party in its competition against the ruling party in the next elections. On the other hand, deregulating financial sector would promise to secure more tax revenues as

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[80] Peter Goldmann, *Fraud in the Markets: Why It Happens and How to Fight It* (Hoboken, NJ: John Wiley & Sons, 2010), 75.
[81] James Crotty, "Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture'," *Cambridge Journal of Economics* 33 (2009): 577.
[82] Robert Yoon, June 29, 2010, "Clinton earns $65 million in speaking fees as private citizen," *CNN Political Ticker Post Blog*, December 22, 2012, http://politicalticker.blogs.cnn.com/2010/06/29/clinton-earns-65-million-in-speaking-fees-as-private-citizen.
[83] David G. Tarr, "The political, regulatory, and market failures that caused the US financial crisis: What are the lessons?" *Journal of Financial Economic Policy* 2, no. 2 (2010): 165.

well as campaign funds from corporations whose business capacity would expand as a result of deregulations. In the longer run, however, deregulating finance is a harmful choice with negative consequences that spread in much wider areas of the economy as they increase the risks of organizational defaults, sectoral deadlock, and macroeconomic collapse.[84] Although these longer-term consequences of deregulations had been noted widely, policymakers in pursuit of their short-term reelectability have not hesitated to choose it as a policy choice to simulate home ownerships in the U.S. society.[85]

Alesina and Tabellini explain such suboptimality in the execution of policymaking duties with differences in priorities among policymakers. They argue that when "vested interests have large stakes in the policy outcome,"[86] non-elected bureaucrats would be more preferable to elected politicians in making public policies, however, in practice, the influence of "opportunistic politicians [who] do not internalize these normative criteria" play a large role in policymaking, because "actual institutions are more likely to be designed so as to deliver maximal rents at the lowest risk for the incumbent politician."[87] In the U.S. political system where corporate funds are the vital sources for electability, and elected officials nominate and appoint non-elected bureaucrats, the theoretical gap between the policy priorities of non-elected bureaucrats and elected officials exists minimally.

Lang and Jagtiani add that "the issues related to corporate governance and principal-agent conflicts have inhibited the function of [financial] firms' internal control and risk management system", and paved the way for excessive risk taking by financial

[84] Eric Tymoigne, "Engineering Pyramid Ponzi Finance: The Evolution of Private Finance from 1970–2008 and Implications for Regulation," in *Heterodox Analysis of Financial Crisis and Reform*, ed. Joëlle Leclaire et al. (Cheltenham, UK: Edward Elgar, 2011).
[85] Ibid., 165.
[86] Alberto Alesina and Guido Tabellini, "Bureaucrats or politicians? Part II: Multiple policy tasks," *Journal of Public Economics* 92 (2008): 426.
[87] Ibid., 445.

corporations.[88] Unrestrained by guidelines that could have controlled instability factors in the sector (such as legal caps on loan-to-asset ratios for lenders or debt-to-income ratios for borrowers), lending institutions have adopted policies that would encourage myopic self-serving behaviors among financiers. Loan officers were often compensated on a commission-only basis with no fixed salary, and a rigidly established division of labor functioned as a harmful dilution of responsibility among mortgage lenders. Consequently, loan officers whose personal incomes were linked to the size of loans they approved without accountability to their consequences have carried out aggressive sales campaigns. They have provided people with loans beyond their means with nearly no consideration of their future capability to handle that debt burden. Furthermore, as the authors highlight, "[…] the originate-to-distribute model, [that is] the securitization process of converting illiquid loans into liquid securities […] distorted incentives and led to a decline in underwriting standards along with predatory lending practices that created the financial crisis."[89] Investors in financial corporations who pressured and rewarded executives for quick returns with a trader-like approach provided further incentives for financial sector executives to adopt a short-term outlook.[90] Executives who have adapted to this new culture of business myopia were compensated heftily for their socially-apathetic but financially-lucrative management style that increased corporate profitability and value in the short run.

Goodhart finds Federal Reserve's policies culpable of the formation of a moral hazard in financial sector, which drove the U.S. economy into crisis in 2008.[91] From the Black Monday of 1987 to the real estate crash in 1992, Asian Crisis of 1997-98 to the tech bubble burst in 2001; Federal Reserve consistently intervened to support the

[88] William W. Lang and Julapa A. Jagtiani, "The mortgage and financial crises: the role of credit risk management and corporate governance," *Atlantic Economic Journal* 38 (2010): 297.
[89] Ibid., p. 306.
[90] Emeka Duruigbo, "Tackling Shareholder Short-termism and Managerial Myopia," *Kentucky Law Journal* 100 (2012)": 531.
[91] Charles A.E. Goodhart, "The background to the 2007 financial crisis," *International Economics and Economic Policy* 4, no. 4 (2008): 332.

financial sector with an argument that financial sector's vitality was essential for the robustness of the larger economy. Predictability of the Fed's attitude towards the financial sector led to a perception in financial markets that they would be rescued by the Fed at all costs. Termed as *the Greenspan put*, this perception functioned as a practical reduction in risk premiums from the perspective of financial institutions, and resulted in massive underpricing of risk in financial instruments. The same expectation of privileged treatment manifested itself in the "too big to fail" argument when Bank of America, AIG, Goldman Sachs, Citigroup, Morgan Stanley and Wells Fargo sought to be rescued from bankruptcy by the government over the course of the crisis.[92]

As toxic loans began to default in 2007, home values began to plummet and deteriorated balance sheets in commercial banks that had operated with minimal equity and substantial liabilities linked to housing prices. Dramatic fall in banks' fiscal conditions applied downward pressure on banks' lending, which in turn, led to a drop in investments and massive layoffs in practically all sectors of the U.S. economy. Unemployment rose rapidly reducing aggregate effective demand to paralyze the output further, and drove the U.S. economy into a deep recession. As Crotty concludes, "the past quarter century of deregulation and the globalization of financial markets, combined with the rapid pace of financial innovation and the moral hazard caused by frequent government bailouts helped create conditions that led to this devastating financial crisis. The severity of the global financial crisis and the global economic recession that accompanied it demonstrate the utter bankruptcy of the deregulated global neoliberal financial system and the market fundamentalism it reflects."[93]

Observers who analyze the Great Recession from the perspective of ideology pinpoint a number of assumptions in mainstream economics as the culprits behind the crisis. Roubini acknowledges the crisis as the "[…] failure of ideas –such as the

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[92] Lang and Jagtiani, p. 313.
[93] Crotty, 575.

'efficient market hypothesis,' which deluded its believers about the absence of market failures such as asset bubbles; the 'rational expectations' paradigm that clashes with the insights of behavioral economics and finance; and the 'self-regulation of markets and institutions' that clashes with the classical agency problems in corporate governance – that are themselves exacerbated in financial companies by the greater degree of asymmetric information."[94] Waller perceives the idea of *laissez-faire* –the proposition that economies function best when they are not constrained by government interference- as an "intellectual construct, […] a logically inconsistent part of classical liberalism, a mild embarrassment to modern liberalism, […] and a potent cultural symbol […] especially in the United States."[95]

Treatment of general equilibrium as a synonym for social efficiency was a shortcoming of the neoclassical theory, which contributed to the conditions that led to the 2007 crisis. Yates writes,

> "Since the notion of social efficiency has been defined prior to its building, and the equilibrium set of prices satisfies this definition, it follows that any deviation from equilibrium will be inefficient. Economists use this model to argue the undesirable consequences of minimum wage laws, labor unions, price controls, rent controls, income taxes, environmental regulations—indeed just about anything a government does. […] Such an economy bears no resemblance to any actual existing economy, nor could it. There is no money in it, no government, no notion that there is a natural world in which production occurs, no workplaces. It is constructed in abstraction from the distribution of wealth and income."[96]

Krugman reveals the vulnerability of market-driven pricing with his explaination of the difference between coherence and soundness in asset prices. In response to Eugene Fama who argued that a homebuyer cannot overpay for a house because he does a thorough investigation of prices in that neighborhood before accepting a price, he writes

[94] Nouriel Roubini, "Laissez-Faire Capitalism Has Failed," *Forbes*, February 19, 2009.
[95] William Waller, "The Political Economy of Laissez-Faire," *Journal of Economic Issues* 40 (2006): 59.
[96] Michael D. Yates, "The Emperor Has No Clothes But Still He Rules: Three Critiques of Neoclassical Economics," *Monthly Review* 63 (2011): 58.

> "indeed home buyers generally do carefully compare prices –that is, they compare the price of their potential purchase with the prices of other houses. But this says nothing about whether the overall price of houses is justified. It is ketchup economics: […] a two-quart bottle of ketchup cost[ing] twice as much as a one-quart bottle [does not mean] that the [unit] price of ketchup [is] right. […] The belief in efficient financial markets blinded many […] economists to the emergence of the biggest financial bubble in history. […] Greenspan's assurances […] weren't based on evidence –they were based on the a priori assertion that there simply can't be a bubble in housing."[97]

Vercelli points out that the Great Recession was the last episode in a long history of economic crises that has become a practical refutation of *laissez-faire ideology*.[98] Markets may have intrinsic mechanisms for self-correction, but they do not operate in an environment free of countervailing forces that steer them to the opposite direction. The proposition of self-correcting market is a truism that builds on an oversimplified supposition that unrestrained individual ambitions serve the common interest –Adam Smith's concept of *invisible hand*. Its agreeability is justified on the basis of the impossibility of its disagreeability in select *post facto* reality.[99] It constitutes an accurate conclusion only in select cases in which it turned out to be true. Internal market conditions do indeed create pressures towards a new equilibrium, but this does not necessarily mean that a new equilibrium would be reached inevitably if government stays out of this process. As increasingly more frequent crises in capitalist economies demonstrate, there is no natural mechanism to assure that market forces that pull the economy towards equilibrium outweigh those that push the economy away from it. Past incidences of self-correction suggest that markets *can* self-correct, but other cases that correction did not occur confirm that self-correction is *not* an inevitable outcome that would definitely be observed –that is, the idea of (always) self-correcting market is a myth based on a tautology that "markets have corrected themselves when self-correction

[97] Paul Krugman, "How Did Economists Get It So Wrong?" *The New York Times,* September 2, 2009, The Times Magazine section.

[98] Alessandro Vercelli, "Economy and Economics: The Twin Crises," in *The Global Economic Crisis: New Perspectives on the Critique of Economic Theory and Policy,* ed. Emiliano Brancaccio and Giuseppe Fontana. (London: Routledge, 2011), 38.

[99] Bülent Temel, "Book review: The Hesitant Hand," review of *The Hesitant Hand: Taming Self-Interest in the History of Economic Ideas*, by Steven G. Medema, History of Economic Thought, 21/3 (2014).

occurred." As Stiglitz wittily puts, "the invisible hand often seems invisible, because it is not there."[100] Interplay between competing forces can create an enormous deadlock that paralyzes the very livelihood of involved sectors as well as the larger economy. As the sole remaining economic actor that is capable of reversing this downward trajectory, government has to step in and provide liquidity to the economy by making massive public investments –even to the expense of higher inflation and debt stock in the longer run.

Acemoglu explains the Great Recession with the economics profession's ideological hostility to the idea of regulations:

> "Our second too-quickly-accepted notion is that the capitalist economy functions in an institution-less vacuum, where markets miraculously monitor opportunistic behavior. Forgetting the institutional foundations of markets, we mistakenly equated free markets with unregulated markets. Although we understand that even unfettered competitive markets are based on a set of laws and institutions that secure property rights, ensure enforcement of contracts, and regulate firm behavior and product and service quality, we increasingly abstracted from the role of institutions and regulations in supporting market transactions in our conceptualization of markets. […] In our obliviousness to the importance of market-supporting institutions, we were in sync with policy makers, who were lured by ideological notions derived from Ayn Rand novels rather than economic theory. We let their policies and rhetoric set the agenda for our thinking about the world and worse, perhaps, even for our policy advice."[101]

Acemoglu further argues that turning to the theory of regulations (in finance as well as the real sector) is a fundamental lesson the Great Recession has taught. He rejects the widely-held criticism of greed as a source of problems in capitalism, and contends that "greed is neither good nor bad in the abstract. When channeled into profit-maximizing, competitive, and innovative behavior under the auspices of sound laws and regulations, greed can act as the engine of innovation and economic growth. But when

[100] Joyce Routson, "Today's Market Behavior Shouldn't Be a Surprise Says Joseph Stiglitz," *Stanford Graduate School of Business*, January 1, 2009.
[101] Acemoglu, p. 39.

unchecked by the appropriate institutions and regulations, it will degenerate into rent seeking, corruption, and crime."[102]

Baker draws a parallel between American and European policymakers' faith in the idea of *self-correcting free market* and the subprime crisis that brought about the global recession in 2007.[103] During the 19 years under Alan Greenspan's governorship (1987-2006), U.S. Federal Reserve leadership consistently considered low inflation rate as its policy priority, and kept its prime rate at a low level to facilitate it. While this approach provided conditions conducive to a steady growth of the U.S. economy, it also led to overvaluations in asset prices. The leadership's submission to a supply-side worldview and its *laissez-faire* faction clouded its approach from appreciating instability factors that grow from inside the system. A self-described "life-long libertarian republican,"[104] Greenspan wrote in his PhD dissertation, which he submitted in 1977 when he was the Chairman of the Council of Economic Advisors, that he believed in permanent, large scale favors to corporations as a solution to temporary economic contractions: "Stimulus should be provided by tax reduction rather than by increases in government spending; tax reduction should be permanent rather than in the form of a temporary rebate; [and] economic initiatives should be balanced between measures to stimulate consumption and those designed to increase business investment."[105] In a 2008 hearing before the Congress, "[...] Greenspan admitted that he had put too much faith in the self-correcting power of free markets and had failed to anticipate the self-destructive power of wanton mortgage lending."[106]

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[102] Ibid., p. 40.
[103] Dean Baker, "Recession culprits? Start with Alan Greenspan and Jean-Claude Trichet," *The Guardian,* June 03, 2013.
[104] Greg Ip and Emily Steel, "Greenspan Book Criticizes Bush and Republicans," *Wall Street Journal,* September 15, 2007, Leader (U.S.) section.
[105] Jim Mactague, "Looking at Greenspan's Long-Lost Thesis," *Barron's,* April 28, 2008, Feature section.
[106] Edmund L. Andrews, "Greenspan Concedes Error on Regulation," *The New York Times,* October 23, 2008, Business section.

According to Roubini, the crisis further refuted the argument that securitization would minimize systemic risk by allowing diversification of organizational risks. "[… Systemic] risk can be properly priced when the opacity and lack of transparency of financial firms and new instruments leads to unpriceable uncertainty rather than priceable risk," he writes.[107] The recession spelled the failure of the "Anglo-Saxon model of supervision and regulation of the financial system," because in practice, self-regulation translates into lack of regulation, and market discipline disappears and internal risk management models lose their attractiveness in times of rapid growth. Combined with the facts that "self-regulating approach created rating agencies that had massive conflicts of interest and a supervisory system dependent on principles rather than rules," the U.S. economy went into a deep recession –compromising the perceived credibility of the *freedom from government intervention* proposition.[108]

A congressional report in 2010 acknowledged that widening income and wealth disparities embraced in trickle-down ideology was an underlying factor that has contributed to the emergence of recession in 2007. "Stagnant incomes for all but the wealthiest Americans meant an increased demand for credit, fueling the growth of an unsustainable credit bubble. Bank deregulation allowed financial institutions to create new exotic products in which the ever-richer rich could invest. The result was a bubble-based economy that came crashing down in late 2007."[109] Kenworthy argue that redistributive taxation within a social democratic framework would not harbor such destructive dynamics.[110] A more homogenous distribution of national income allows for a faster growth in real output, because as Keynes explained in his *absolute income hypothesis*, marginal propensity to consume is higher in lower income levels. As money

[107] Roubini, 2009.
[108] Ibid.
[109] U.S. Congress Joint Economic Committee, *Report on Income Inequality and the Great Recession,* United States Senate, 111th Congress, (2010).
[110] Lane Kenworthy, "America's Social Democratic Future: The Arc of Policy Is Long But Bends Toward Justice," *Foreign Affairs* January/February (2014): 86-100.

goes to more people who spend more of their income; aggregate effective demand and accordingly investment, output and employment remain at optimally high levels.

Danziger emphasizes that the Great Recession was associated with the growing gap between real output and real wages in American society. Although GDP per capita had arisen rapidly since the early 1970s, wage inadequacy and poverty rates were higher at the onset of the crisis in 2007. "Changes in employer practices, labor market […], and […] public policies have all contributed to a situation in which most workers no longer captured the benefits of rising labor market productivity."[111] Consequently, indebtedness made available by favorable borrowing conditions imported from abroad has become the main way by which a vast majority of Americans coped with their declining purchasing power. The outcome was excessive indebtedness on personal, organizational, sectoral and governmental levels, which elevated the level of systemic risk while minimizing the policy space to respond to the likely realization of its constituent risks.[112]

Heterogeneous distribution of income/wealth is a universal phenomenon in capitalist economies, but its association with economic instability appears to exist only at cultural level where "country-specific social norms play an important role."[113] Stagnation of real average wages *vis-à-vis* the growth in real output results in lower private consumption rates and domestic aggregate demand, and higher export-led growth in China and Germany whereas it leads to increased indebtedness and current account deficit in the United States. As the common American culture based on conspicuous consumption is among the root causes of the subprime crisis at earlier phase of the global meltdown, the Great Recession spells a failure of the ideology that domestic

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[111] Sheldon Danziger, "Evaluating the Effects of the Great Recession," *The Annals of the American Academy of Political and Social Science* 650 (2013): 8.
[112] IMF & ILO, 2010. "The Challenges of Growth, Employment and Social Cohesion." Paper presented at the *ILO-IMF Conference*, Oslo, Norway, September 13, 2010, p. 8.
[113] Till van Treeck and Simon Sturn, *Income inequality as a cause of the Great Recession? A survey of current debates* (Geneva: ILO, 2012), 50.

consumption is an essential requirement of national prosperity –a neoclassical proposition that treats "consumption as an accurate indicator of welfare."[114]

Colander et al. perceive the Great Recession as a "systemic failure of the economics profession" that has ignored the fragility of the assumptions in neoclassical theory.[115] Beginning from the early 1980s, liberal vision of economics that promotes markets as the sole purpose of economic activity and a reliable solution to all problems in the society was promoted across America with impressive success. Dissolution of the Soviet Union, which marked the ending of the Cold War in 1981, was framed in the political discourse as the victory of not only capitalism over socialism, but also of liberalism over authoritarianism. This victory provided the social psychological base needed for a new understanding of economics that combined the economic system of capitalism with the sociopolitical system of liberalism. Spelling the ideal way an economy works from the perspective of the capitalist elite since the times of feudal manorialism in medieval Europe, a new version economic liberalism that advocated for low taxes, deregulations, de-unionization, privatizations and unrestricted foreign trade has arisen to prominence. Authors note,

> "[…] economics has been trapped in a sub-optimal equilibrium in which much of its research efforts are not directed towards the most prevalent needs of society. Paradoxically, self-reinforcing feedback effects within the profession may have led to the dominance of a paradigm that has no solid methodological basis and whose empirical performance is, to say the least, modest. Defining away the most prevalent economic problems of modern economies and failing to communicate the limitations and assumptions of its popular models, the economics profession bears some responsibility for the current crisis."[116]

Rhoades and Slaughter shed light on the link between commercialization of academia and academic embracement of the pro-corporate outlook irrespective of

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[114] Daniel T. Slesnick, *Consumption and Social Welfare: Living Standards and their Distribution in the United States* (Cambridge, UK: Cambridge University Press, 2000), 3.
[115] David Colander et al. "The Financial Crisis and the Systemic Failure of the Economics Profession," *Critical Review* 21 (2009): 249.
[116] Colander et al., p. 262.

evidence in the United States.[117] This environment of "academic capitalism," in which 83% of professors are not tenured,[118] and promotions to tenure are closely linked to the ability to bring research grants to universities compels scholars to adopt pro-corporate priorities, and a supply-side perspective subsequently dominates mainstream thinking. Research papers often conclude with a tone that is advantageous to sponsors of research while findings to the opposite effect are treated to be counterproductive and buried in academic language. Spread of the supply-side mindset in the U.S. academia leads to a hazardous cycle that transformed economists from social philosophers who work to improve human conditions into self-serving optimization experts who use ostentatious techniques to serve corporate interests.

In their investigation of the monetary link between financial corporations and the 19 prominent economists who have prepared financial sector reform packages in the wake of the Great Recession, Carrick-Hagenbarth and Epstein found that it appears "[…] quite rare for the academic financial economists in our study to identify their private affiliations even when writing about financial regulatory issues that might affect the private firms for which they work.[119] An examination of 96 Senate testimonies delivered by 82 academic economists at the Banking and Financial Services Committees between 2008 and 2010 found "no clear standard for disclosure" of their private sector affiliations such as board memberships or paid consultancy arrangements.[120]

In the years leading up to the Great Recession, ideological submission to free market economics caused the calls for more regulations in the large and rapidly growing over-the-counter derivatives (OTCD) market to be consistently dismissed in

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[117] Gary Rhoades and Sheila Slaughter. "Academic Capitalism in the New Economy: Challenges and Choices," *American Academic* 1 (2004): 37-60.
[118] US Department of Education, National Center for Education Statistics, available at http://nces.ed.gov/ipeds/, accessed March 14, 2014.
[119] Jessica Carrick-Hagenbarth and Gerald A. Epstein, "Dangerous interconnectedness: economists' conflicts of interest, ideology and financial crisis," *Cambridge Journal of Economics* 36 (2012), 45.
[120] Ibid., p. 46.

policymaking –allowing these instruments to drive the economy to collapse in 2007. In the late 1990s, the then-chairperson of the Commodity Futures Trading Commission, Brooksley Born took attention to the fact that OTCD were used as gambling instruments that could bring down large financial corporations, and demanded larger oversight of this market. The President's Working Group, consisted of the then-Fed Chairman Alan Greenspan, Treasury Secretary Robert Rubin and Assistant Treasury Secretary Larry Summers, responded to Born's repeated efforts by convincing legislators to disallow her commission to regulate the OTCD market. They argued that changes Born advocated would have the U.S. economy lose international competition to regulatory arbitrage as OTCD investors would invest their funds in the U.S. to alternative financial centers like London.

The recession unveiled that privatizing credit rating function in an economy is an idea that is doomed to failure in terms of policymaking. Commercial credit rating agencies (50% of this market share is with the "Big Three" -Standard and Poor's, Moody's and Fitch) has become instrumental in concealing true risks of various debt obligations with their inflated ratings. The Financial Crisis Inquiry Commission concluded its investigation of the dynamics that led to the crisis that these commercial businesses have consistently underestimated the risk levels due to "flawed computer models, the pressure from financial firms that paid for the ratings, the relentless drive for market share, the lack of resources to do the job despite record profits, and the absence of meaningful public oversight."[121]

Explanations of the Great Recession in terms of malfunctions in monetary dynamics constitute the most immediate and popular response given to the crisis. In this view, unrestricted international mobility of capital allowed substantial amounts of funds to flow in the U.S. economy creating perverse incentives for excessive risk-taking in the

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[121] "Conclusions of the Financial Crisis Inquiry Commission," http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf.

U.S. economy and its financial sector. As Brunnermeier underlines, over the years leading to the meltdown in 2007, Chinese and Japanese governments have purchased $3 trillion worth of U.S. treasury and corporate securities and equities "to peg the exchange rates at an export-friendly level and to hedge against a depreciation of their own currencies against the dollar, a lesson learned from the Southeast Asian crisis of the late 1990s."[122]

Substantial inflows of Asian savings into the U.S. economy have created injurious distortions as well as opportunities politically and economically. On the political side, it increased the economic tie between two largest economies in the world, which, according to *commercial pacifism hypothesis*, endorses peaceful relations between political leaderships in the United States and China by "reducing expected utility of warfare."[123] It has also given Chinese leaderships substantial political leverage to compel the U.S. government to pursue policies favorable to Chinese interests as a large scale unloading of the U.S. holdings would result in a rapid depreciation of the U.S. dollar and equity values, which increases interest rates, and consequently the output gap, unemployment and federal budget deficit in the United States.[124] Economically, uncontrolled foreign capital inflows into the U.S. economy led to a perception that financial capabilities of the U.S. is unlimited, and ever-growing federal deficit and debt burden are sustainable.[125]

Favorable and seemingly-sustainable international borrowing conditions led policymakers to consistently demonstrate preference for monetary policy over fiscal policy in improving the investment climate in the country. Federal Reserve reduced its

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[122] Markus K. Brunnermeier, "Deciphering the Liquidity and Credit Crunch 2007–2008," *Journal of Economic Perspectives* 23 (2009): 77.
[123] Gil Friedman, "Commercial Pacifism and Protracted Conflict: Models from the Palestinian-Israeli Case," *Journal of Conflict Resolution* 49 (2005): 362.
[124] Congressional Research Service, China's Holdings of U.S. Securities: Implications for the U.S. Economy, United States Senate, Order code RL34314 (2008).
[125] Michael Boskin, "Federal Government Deficits: Some Myths and Realities," *American Economic Review* 72 (1982): 296-303.

prime rate in 2001 in order to stimulate the economy in the aftermath of the burst technology bubble, and sustained this policy for the following five years in response to increased unpredictability after the September 11 attacks. As crude oil prices began to increase, partly in response to the U.S. occupation of Iraq in 2003, the Fed brought federal funds rate from 6.5% to 1% to subsidize the corporations challenged by increased input costs. The policy brought mortgage rates down to historical lows as the national average contract mortgage rate came down to %5.50 in 2004 after a consistent fall from a peak at %14.50 in 1982.[126]

Federal Reserve's lax interest policy in the years leading up to the crisis endorsed the rise of leveraging as a cultural norm in corporate America. Jeanne notes that "One thing that we are starting to better understand is the welfare case for curbing the boom-bust cycles in capital flows. The research agenda on the new welfare economics of prudential capital controls […] explains the need for regulating capital flows by systematic externalities generated by financial frictions. It explains precisely in which sense capital inflows can be deemed to be "excessive" from the point of view of the country's welfare, which occurs when private agents do not internalize the contribution of their own borrowing to the risk and severity of a systemic crisis."[127] Reich adds that the sustained low-interest policy was a radical choice that should have been supplemented by prudent regulations: "Greenspan's worst move was to [...] lower interest rates to 1%, enabling banks to borrow money for free, adjusted for inflation. Naturally, the banks wanted to borrow as much as they possibly could, then lend it out, earning nice profits. The situation screamed for government oversight of lending

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[126] "Historical Performance of the National Average Contract Mortgage Rate," accessed January 30, 2013, http://mortgage-x.com/trends.htm.

[127] Olivier Jeanne, "Capital Mobility and Regulation," in *Global Economics in Extraordinary Times: Essays in Honor of John Williamson*, ed. C. Fred Bergsten and C. Randall Henning (Washington, DC: Peterson Institute for International Economics, 2012), 149.

institutions, lest the banks lend to unfit borrowers. He refused, trusting the market to weed out bad credit risks. It did not."[128]

Blanchard et al. argue that low interest rates were also detrimental to the economy in terms of weakening the instrumentality of monetary policy during the Great Recession. Over the course of the three years following late 2007, many central banks around the world lowered their prime rates to near-zero level in an effort to stimulate output in their economies. However, because the rate had been at an already-low level when the crisis broke out, percentage points by which the rate was lowered have become limited. Subsequently, the impact of the rate cutting policy has become minimal, and deficit-increasing fiscal policy had to be introduced as a supplemental measure. Authors argued that a primary lesson from the Great Recession was the need to consider higher levels of optimal inflation and interest rates while taking policy precautions to prevent volatility in inflation.[129]

Low cost and widely available funds drove commercial banks and lenders to issue sizeable loans to borrowers beyond their means, and a new category of risky credit was launched in financial markets under the name *subprime loans*. In a business culture dominated by short-term self-interest and encouraged by a political culture of service to paying interests, commercial lenders that are given unwise leeway by federal regulators continuously dumped their toxic loan portfolios to securities markets, which concealed these loans in complex derivative instruments. A number of new over-the-counter (OTC) derivative instruments like structured investment vehicles (SIVs) or collateralized debt obligations (CDOs) with "hideous complexity and opaqueness" that signaled

[128] Robert Reich, "Alan Greenspan by Robert Reich," *The Guardian,* January 17, 2009, World News section.
[129] Olivier Blanchard, Giovanni Dell'Ariccia and Paolo Mauro, "Rethinking Macroeconomic Policy," *Journal of Money, Credit and Banking* 42 (2010): 205.

"deliberate deception" were given permissions to be created and traded by the regulators.[130]

Credit default swaps (CDSs) became exempted from gaming laws in 2000 by the legislators, which rapidly attracted investors who purchased CDSs for quick returns rather than for risk hedging (essentially, CDSs are default insurance premiums paid for a third party's debt). As the CDS market had grown from $900 billion in 2000 to over $50 trillion within eight years, it had exposed the insurance segment of the financial sector to an unbearable collapse potential in the case of a large-scale defaults in mortgage loans. Similarly, permissions and deregulations on collateral mortgage obligations (CMOs) and other mortgage backed securities (MBSs) incentivized lenders to sell these instruments for a lower risk premium than what they really entailed. Rajun et al. note "'soft information' about borrowers' capacity to repay that is difficult to communicate in mathematical models to the final investors of securitized loans is subject to manipulation by lenders seeking origination income."[131] Eichengreen acknowledges the role mathematics has played in this process:

> "Development of mathematical methods designed to quantify and hedge risk encourage commercial banks, investments banks and hedge funds to use more leverage as if the very use of mathematical models diminished the underlying risk.[132] […] Mathematical rigor and numerical precision of risk management and asset pricing tools has a tendency to conceal the weaknesses of models and assumptions to those who have not developed them and do not know the potential weakness of the assumptions."[133]

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[130] Christopher R. Whalen, "The Subprime Crisis--Cause, Effect and Consequences," *Journal of Affordable Housing & Community Development Law* 17, no. 3 (2008): 225.
[131] Rajun, U; A. Serun, and V. Vig (2009). "The Failure of Models that Predict Default: Distance, Incentives, and Default." Chicago GSB Research Paper No. 08-19.
[132] David Colander et al., "The Financial Crisis and the Systemic Failure of the Economics Profession," *Critical Review* 21, no. 2 (2009): 253.
[133] Ibid., 254.

Chow and Foster find that John M. Keynes's *liquidity trap* hypothesis has substantial explanatory power in the case of the Great Recession.[134] According to this argument, economic actors form expectations that adapt to the economic reality of the recent past, which, at times of stress, compromises the instrumentality of monetary policy as an economic stimulant, and magnifies sectoral stresses into full blown crises in the larger economy. In his general theory that introduced a new function for fiscal policy, Keynes explained this argument with human nature. He noted that marginal productivity of capital is a function of two separate influences: probabilities of possible yields, and confidence in the likelihood of their occurrence. Economic actors' confidence is shaped by the "weight of argument," which is the scope of relevant evidence that supports a proposition. Even when the argument weighs low as in times of increased economic uncertainty, innate human propensity for action (or "animal spirits") mobilizes economic actors to make productive decisions based on arbitrary judgments, customary decisions, and psychological tendencies. Crises occur and sustain when economic actors lose this spirit in response to economic events of the recent past, and depositors prefer bank runs over confidence in banks and financial institutions hoard liquidity rather than use them for productive purposes:[135] "[…] most probably, our decisions to do something positive, full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits, a spontaneous urge to action rather than inaction, not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities. […] if the animal spirits are dimmed and the spontaneous optimism falters, leaving us nothing but mathematical expectation,

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[134] Peter C. Y. Chow and Kevin R. Foster, "Liquidity traps or Minsky crises: a critical review of the recent U.S. recession and Japan's Heisei recession in the 1990s," *Journal of Post Keynesian Economics* 32 (2010): 588.
[135] Kevin D. Hoover, "Is There a Place for Rational Expectations in Keynes's General Theory?" in *A Second Edition of The General Theory: Volume 1,* ed. Geoffrey Harcourt and Peter Riach (London: Routledge, 1997), 222.

enterprise will fade and die, -though fears of loss may have a basis no more reasonable than hopes of profit had before."[136]

During the crisis, financial institutions have lost their enthusiasm to fund investments in the economy after they passed a perceived threshold default rate that distinguished unbearable losses from bearable ones. Consequently, increased interest rates and loan eligibility requirements resulted in diminished scale of lending, and slowed down economic activity in vast areas of economic activity. As the slowdown caused fund availability to decline, it applied further upward pressure on interest rates, and left the economy in a state of unholy spiral –the state of crisis that seemed irreversible by market dynamics alone.

Cardarelli et al. advance the view that the meltdown in 2007 was associated with the fact that sectoral stress in preliminary phases of the crisis was in financial sector rather than any other sector. Increased default rates in the mortgage sector challenged the banking sector with large mortgage-backed holdings, which resulted in cutbacks on lending and production in the economy. Authors conclude that "financial turmoil characterized by banking distress is more likely to be associated with deeper and longer downturns than stress mainly in securities or foreign exchange markets."[137] As Galbraith recognized in 1975, "a bank failure is not an ordinary business adventure. […] it has not one but two adverse effects on economic activity: Owners lose their capital and depositors their deposits, and both therewith lose their ability to purchase things. But failure (or for that matter, fear of failure) also means a shrinkage in the money supply."[138]

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[136] John Maynard Keynes, *The General Theory Of Employment, Interest, And Money* (Boston, MA: Houghton Mifflin Harcourt, 1965), 81-2.
[137] Roberto Cardarelli, Selim Elekdağ, and Subir Lall, "Financial stress and economic contractions," *Journal of Financial Stability* 7 (2011): 78.
[138] John K. Galbraith, *Money: Whence It Came, Where It Went* (Harmondsworth, UK: Penguin, 1975), 121.

A group of scholars highlight the psychological factors that led to the recession in 2007. Barnett et al. argue that the ideological influence of the neoliberal transformation of government and economy spread into the social sphere by "subjectivating" individuals into consumers whose consumption choices satisfy not only personal needs and wants, but also requirements of good citizenry.[139] "[…] conceptualizations of neoliberal governance and advanced liberal governmentality can throw light on contemporary transformations in the practices and politics of consumption, […] and the analytics of governmentality provide a coherent theoretical account of how political processes of rule and administration […] connect up with cultural processes of self-formation and subjectivity."[140] Consumption as a form of self-realization has been an element of the radicalization of individualism in America within the context of the neoliberal transformation. With its emphasis on unrestricted economic activity and freedom from regulatory authority, culture of neoliberalism glorifies a radical version of individualism that subordinates social concerns to self-interest.

Wong highlights the social psychological link between radical individualism and competitive consumption.[141] In a culture that promotes self-service without any social concerns, individuals feel emotionally unstimulated and perpetually lonely. In order to compensate this sentimental deficiency, they turn to materials for comfort: "Levels of individualism bear a direct and positive relationship to materialism as defined in our existing literature. […] Materialists in general do tend to link conspicuous consumption to the desire for display of success and to arouse the envy of others."[142] This behavioral propensity is a definitive component of a consumption society, on which the domestic-

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[139] Clive Barnett, Nick Clarke, Paul Cloke and Alice Malpass, "The elusive subjects of neoliberalism: Beyond the analytics of governmentality," *Cultural Studies* 22 (2008): 624-53.
[140] Ibid., p. 625.
[141] Nancy Y. C. Wong, "Suppose You Own the World and No One Knows? Conspicuous Consumption, Materialism and Self," in *Advances in Consumer Research: Volume 24*, eds. Merrie Brucks and Deborah J. MacInnis (Provo, UT: Association for Consumer Research, 1997).
[142] Ibid., p. 201.

oriented U.S. economy where exports are only 14% of the GDP[143] thrives. From small businesses to large conglomerates, commercial enterprises in the U.S. take advantage of promotional tools of trade to manipulate the public into believing that buying newer, bigger and better things on a continuous basis is the recipe for happiness. Commercial influence by means of mass media and provocative incentives such as low interest rates or balloon mortgages compel masses with limited financial literacy to consume endlessly and habitually.[144] As Perkin points out, in a radically individualistic environment that does not offer sentimental social rewards for achievement, ostentation becomes a way of self-realization by means of status.[145]

Acemoglu finds "intellectual complaisance" as a behavioral factor that contributed to the crisis in 2007. A long period of economic growth with minor and infrequent interruptions since WWII planted a false sense of security in American society –including policymakers and academics who deal with economic matters."[146] Aikman concurs that the Great Recession was a failure of rectitude on the part of the policymakers in the United States. Unpredictability is an unavoidable feature of economies due to the fact that economic performance is a function of a diverse range of human behaviors. In the face of uncertainty, economic actors "often use rough heuristics, or go on first impressions, appearances, gut instinct or intuition […] because of limited time, information and cognitive capacity."[147] In response, policymakers typically attempt to minimize the likelihood of such destructive hysteria by enhancing the public perception of the credibility of their forecasts. However, "As the crisis of the

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143 "Exports of goods and services (% of GDP)," http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS/countries.
144 Karen B. Halnon, *The Consumption of Inequality: Weapons of Mass Distraction* (Hampshire, England: Palgrave Macmillan, 2013).
145 Harold Perkin, "Review of the Theory of the Leisure Class by Thorstein Veblen," *Economic History Review* 25, no. 4 (1972): 737.
146 Daron Acemoglu, "The Crisis of 2008: Structural Lessons for and from Economics," in *Globalization and Growth: Implications for a Post-crisis World,* ed. Michael Spence and Danny Leipziger (Washington, DC: World Bank, 2010), 38.
147 David Aikman, "Uncertainty in macroeconomic policy-making: art or science?" *Philosophical Transactions* 369 (2011): 4802.

autumn of 2008 showed, such systems can sometimes be subject to abrupt changes, the precise timing of which cannot easily be identified in advance."[148] Motivated to boost confidence in its predictions among economic actors, policymakers often fail to communicate the real vulnerability of their predictions to the public. Over the decade that led to the crisis in 2007, this communicative failure occurred frequently, and resulted in the concentration of economic behaviors to the expense of a more realistic and sophisticated approach.

Koutsobinas contends that "explanations of the crisis cannot be reduced solely to mechanics of market fundamentalism. Behavioural and, more precisely, human psychology considerations were independent, important determinants and their role must be reflected fully in economic analysis."[149] He shows that asset prices always increase faster than corporate profits at expansionary periods. As the gap between asset and profit increases grow, investors would be inclined to anchor their perception of asset prices on the (slower) growth in the real sector. Subsequently, a perception of overvaluations began to form in asset markets –motivating traders to adopt negative expectations from the asset classes that are considered volatile. In the earlier phase of the mortgage meltdown in 2007, collateralized debt obligations took the largest hit due to their feature as an underlying asset of high volatility. This psychology among the traders led to rapid fire sales in these instruments, which had been accumulated into significant portions in many bank portfolios. Rapid and large scale falls in derivative-based assets in bank portfolios drove banks towards bankruptcy, and magnified the sectoral crisis in finance into a full-blown recession in the U.S. economy.

[148] Aikman, p. 4816.
[149] Thodoris Koutsobinas, "A Keynes moment in the Global Financial Collapse," *Real-World Economics Review* 52 (2010): 95.

Kessler explains this contagion with the concept of *cognitive dissonance*.[150] He argues that the stress in mortgage sector spread on the entire economy in 2008 due to the U.S. government's reluctance to intervene with the sectoral stress at an earlier phase. This reluctance was an outcome of the economics profession's rigid embracement of the *efficient market hypothesis*. Reflecting on the idea introduced by psychologist Leon Festinger in 1957, he argues that economists display propensity to embrace their convictions more strongly when practical evidence refute these convictions. As their beliefs in the accuracy of certain ideas are undermined empirically, economists feel psychological discomfort, and they seek to alleviate it by defending those beliefs more vehemently. He argues that this psychological tendency creates inconsistent convictions that often defy rational inferences, which are exacerbated when subject beliefs are held strong enough for the individual to identify himself with them. Analyzing the results of his survey of 374 economists in the United States, Kessler concludes that this is a pitfall for prominent economists of the present time as reaching to the top of the profession requires a formidably expansive skillset in economics, which raises the stakes of changing opinions too high to be a valid option.[151]

For Akerlof and Shiller, the Great Recession was precipitated by consumers' and financial institutions' cautious propensity to hoard liquidity.[152] Removal of substantial amount of money supply from the economy drastically reduced aggregate demand – causing slowdown in productive activities, and increasing layoffs. "We will never understand important economic events unless we confront the fact that their causes are largely mental in nature," they note, "theory has ignored the role of animal spirits [… and] the fact that people could be unaware of having boarded a rollercoaster."[153] Gorton recognizes the meltdown that began in August 2007 as a "wholesale panic" that is

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[150] Adam Kessler, "Cognitive dissonance, the Global Financial Crisis and the discipline of economics," *Real-World Economics Review* 54 (2010): 2-18.
[151] Ibid., p. 6.
[152] George A. Akerlof and Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy and Why It Matters for Global Capitalism* (Princeton, NJ: Princeton University Press, 2009).
[153] Ibid., p. 1.

distinct from other banking panics that occurred over the two centuries prior to it.[154] He argues that while earlier *bank runs* were executed by depositors who liquidated their deposits, which rendered banks unable to meet their obligations; the present panic was *banks' runs* –that is, the banks' common decision to discontinue repo orders, increase repo margins, and demand deleveraging from each other. As repo depositors increased haircuts in the system –demanding obligations to be collateralized by equity to a larger extend, banks could not fund investments by debt or equity sales, and went on to sell their assets in order to maintain the convertibility of their obligations. As the new issue loans declined by 47% from the 3rd quarter to the 4th quarter of 2008 (the peak of the crisis), and by 79% from the 2nd quarter of 2007 (the peak of the credit boom);[155] financial institutions were driven towards insolvency.

Twenge draws a parallel between the rising prevalence of narcissism in American society and the current economic crisis in the U.S. economy: "An inflated sense of self often known as self-centeredness or arrogance, narcissism is the unrecognized psychological component of the bubble economy."[156] Starting from the 1960s, rising economic prosperity and the political climate of individualistic freedom remolded common American personality from a self-made independence that embraced ambition, patriotism, Protestant work ethic, patriarchy and devaluation of leisure to a narcissistic mindset that values short-termism, nihilism, emotional detachment, self-aggrandizement and egocentrism.[157] "Narcissism predicts materialism, compulsive spending, risk-taking, and even gambling. If even a small number of consumers are willing to go into risky amounts of debt to impress their neighbors and satisfy their

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[154] Gary Gorton, "Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007" (paper presented at the Federal Reserve Bank of Atlanta's 2009 Financial Markets Conference: Financial Innovation and Crisis, Atlanta, Georgia, May 11-13, 2009).
[155] Victoria Ivashina and David S. Scharfstein, "Bank Lending During the Financial Crisis of 2008," *Journal of Financial Economics* 97 (2010): 319
[156] "The psychology behind the recession," last modified March 18, 2010, http://www.psychologytoday.com/blog/the-narcissism-epidemic/201003/the-psychology-behind-the-recession.
[157] Imogen Tyler, "From `The Me Decade' to `The Me Millennium': The cultural history of narcissism," *International Journal of Cultural Studies* 10 (2007): 353.

inflated self-images, the prices of real estate are driven upward. Before long, ordinary homebuyers were considering unconventional loans just to get into the market before everything became unaffordable."[158]

Barberis uses *representativeness heuristic* in his explanation of the psychology behind the bubble in real estate market that burst in 2008.[159] He points out that the bubble has become the latest confirmation of a large literature in psychology that sheds light on a responsive tendency in decision making. Unlike in other markets, price increases in real estate market stimulate potential consumers into further consumption. Consumers make their consumption decisions in response to information that is too recent and small, and this bias motivates them to extrapolate real estate prices excessively. In early 2000s, this false optimism has driven house prices towards exorbitant levels that are not explainable by demand and supply dynamics in the market –a phenomenon Alan Greenspan described as *irrational exuberance*.[160]

According to Shefrin, "The root cause of the financial crisis that erupted in 2008 is psychological. In the events which led up to the crisis, heuristics, biases, and framing effects strongly influenced the judgments and decisions of financial firms, rating agencies, elected officials, government regulators, and institutional investors."[161] *Herd behavior* was a social psychological factor behind the real estate bubble that morphed into a recession in 2008. The author echoes John M. Keynes who as early as the mid-20th Century observed that consumers make consumption decisions based on whether or not

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[158] "The psychology behind the recession," last modified March 18, 2010, http://www.psychologytoday.com/blog/the-narcissism-epidemic/201003/the-psychology-behind-the-recession.
[159] Nicholas Barberis, "Psychology and the Financial Crisis of 2007-2008," in *Financial Innovation: Too Much or Too Little?* ed. Michael Haliassos. (Cambridge, MA: MIT Press, 2013), 15-28.
[160] Alan Greenspan, "The Challenge of Central Banking in a Democratic Society" (speech, Washington, DC, December 5, 1996), Federal Reserve, http://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm.
[161] Hersh Shefrin, "How Psychological Pitfalls Generated the Global Financial Crisis," in *Voices of Wisdom: Understanding the Global Financial Crisis* ed. Laurence B. Siegel. (Charlottesville, VA: CFA Institute, 2010), 1.

market price of the subject commodity has been increasing rather than whether or not it reflects the true value of the commodity. Because they are not fully-informed, perfectly-rational value calculators; their judgments often create suboptimal valuations in asset markets.

Szyszka argues that "The financial crisis confirmed the failure of rating agencies […] with regard to the assessment of risk in mortgage-based financial products, [and] many of these mistakes can be explained on behavioral grounds."[162] He identifies *status quo bias* as one of these behavioral pitfalls. Economic actors have a propensity to adopt the established ways of doing business rather than inventing new ones. Displaying this tendency, ratings agencies such as Moody's and Standard & Poor's have conventionally used the same statistical tools with a short-term outlook in their assessments of risk in all asset classes. However, while volatility in a limited duration in the recent past predicts future volatility in most classes of securities such as stocks or bonds, it is insufficiently suggestive in predicting the risk levels securities linked to mortgage loans, which typically have a 30-year maturity. Innovative loan types such as balloon mortgages or adjustable rate mortgages have made future loan repayments even less predictable due to their peculiar designs. Consequently, rating agencies end up underestimating the risks involved in most mortgage-backed securities, and misled investors and financial institutions into paying them more attention than their true risk levels would warrant.

Systemic approaches to the recession explain the crisis in terms of various dynamics endogenous to the capitalist way of organizing production and distribution. Following Hyman Minsky's observation of the stages of capitalist transformation, Wray attributes the crisis to "money manager capitalism –characterised by highly leveraged funds seeking maximum total returns (income flows plus capital gains) in an

[162] Adam Szyszka, "Behavioral Anatomy of the Financial Crisis," *Journal of Centrum Cathedra* 4 (2011): 121-35.

environment that systematically under-prices risk."[163] Over the decades leading to the crisis in 2007, relaxed supervision and regulations of financial actors have allowed the creation and the use of opaque financial instruments to conceal the toxicity of improper loans as underlying assets. As loan defaults reached a threshold level that could not be offset by new values generated, social safety net that had been downsized within the context of the transformation towards small government drove consumers to unemployment, decreased consumption and homelessness, and the financial crisis turned into a full scale recession. Whalen adds that a conflict of interests in the credit rating industry was another contributor to the emergence of this "Minsky moment."[164] The fact that credit rating agencies were compensated by financial institutions that sold innovative instruments agencies rated created a clear conflict of interest that should have been addressed by regulators of the financial system. Concerned with the prospects of losing the banks' business to competition, rating agencies have consistently underestimated the true potential of volatility in newly created instruments – exacerbating the vulnerability to crisis highlighted in Minskian thought.

Ivanova finds Marxian interpretation of the recession to have a larger explanatory power than the Minskian approach.[165] She points out that overaccumulation of capital as a result of continuous reinvestments into technology and machinery brings down corporate profitability in the United States. Corporate actors deal with this challenge by creating new sales and production markets abroad –a phenomenon called the *spatial fix*. Financialization of the economy and the ever-widening practice of outsourcing are mutually-supporting elements of globalization that have laid the groundwork for the mortgage meltdown in 2007. Fall in real purchasing power of

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[163] L. Randall Wray, "The rise and fall of money manager capitalism: a Minskian approach," *Cambridge Journal of Economics* 33 (2009): 809.
[164] Charles J. Whalen, "The U.S. Credit Crunch of 2007: A Minsky Moment," The Levy Economics Institute of Bard College policy brief no.92 (2007). Available at http://www.levyinstitute.org/pubs/ppb_92.pdf.
[165] Maria N. Ivanova, "Marx, Minsky, and the Great Recession," *Review of Radical Political Economics* 45 (2013): 59-75.

American middle class was compensated by excessive indebtedness facilitated by a formidable financial sector. Ivanova adds that the repeated occurrence of crises in capitalist economies further compromise the credibility of the Minskyan proposition that prudent macroeconomic policies and regulations are proper remedies for financial instability inherent to capitalism. “Outward expansion of U.S. productive capital, coupled with financialization at home, has transformed the deep structure of the U.S. economy, making it progressively less responsive to stabilization efforts along Minskyan lines.”[166]

Foster et al. argue that unproductive components drive the economy towards contraction when they reach a significant level, and the Great Recession has become the latest crisis that reallocated resources towards higher productivity.[167] Echoing Joseph Schumpeter’s *creative destruction* hypothesis, which argues that technical advances generate productivity-enhancing progress by crowding out unproductive elements in economies, the authors contend that economic crises create necessary conditions for the economy to be restructured towards higher productivity. Because opportunity costs of resource use are lower during recessions, reallocation of resources towards more productive uses are theoretically expectable in contractionary periods. Author find that this “cleansing” effect was observable in all recessions they analyzed -though it was weaker during the Great Recession due to the unusually adverse unemployment challenges that occurred in the U.S. labor market.

Acemoglu argues that oligopolization in modern finance can result in *creation* to be outpaced by *destruction* during this process of resource reallocation. “There is another sense in which the myth of the end of the business cycle is at odds with

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[166] Ibid., p. 61.

[167] Lucia Foster, Cheryl Grim and John Haltiwanger, “Reallocation in the Great Recession: Cleansing or Not?” Working Paper 13/42 (Center for Economic Studies, 2013), http://www.frbatlanta.org/documents/news/conferences/13caed/A_3_Grim.pdf?d=1&s=blogmb (accessed August 28, 2014).

fundamental properties of the capitalist system," he writes.[168] While Schumpeter's creative destruction argument still holds true, business reality of the present era is one that consists of a few large actors dominating the financial field. Consequently, "replacement of their core business by new firms and new products will have aggregate implications."[169] As the Great Recession during which the formidable U.S. economy halted while some of the world's largest financial institutions detoxified their balance sheets, destruction caused by the reallocation of resources within the economy could be more substantial and immediate than innovative outcomes within the context of this transformation. The fact that many non-sector-specific technologies are used by financial conglomerates in various sectors of the economy further magnifies the ramifications of their replacement with more innovative alternatives.

Crotty attributes the Great Recession to increased financialization of the U.S. economy since the early 1980s.[170] Financial assets, which were four times the U.S. GDP in 1980, had become ten times the GDP by 2008 as the household debt rose to 100% of GDP from its 1981 level of 48%; and private sector debt had risen from 123% of the GDP to 290% of it in 2008. Financial institutions' indebtedness had also risen from 22% of GDP to 117% within three decades, and financial stocks had grown to represent 23% of capitalization in NYSE from 6% in 1981. As profits from financial instruments rose from 10% to 40% of corporate profits, production of real goods and services has become a smaller segment of corporate activity in America.[171] Increased significance of financial markets in corporate performance caused corporate governance to be characterized by short-termism and herd behavior, which are detrimental to organizational and macroeconomic stability. As Palley notes, "[…] the notion of the market for corporate control, whereby managers are disciplined by the prospect of takeover and ouster if they

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[168] Acemoglu, p. 39.
[169] Ibid.
[170] James Crotty, "Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture'," *Cambridge Journal of Economics* 33 (2009): 563-80.
[171] Ibid., p. 575.

fail to maximize profits, […] may simply shift the agency problem from corporate managers to money managers in financial markets."[172]

Shifts in corporate attention towards financial investments, and in income transfers towards finance led to a deterioration of income distribution and wage stagnation. Author concludes that "the lesson of the 2001-06 house price bubble" was that excessive financialization facilitates the creation of "cognitive dissonance" in policymaking. In recessionary periods, policymakers feel obliged to prevent rapid declines in asset prices, which would bring down the entire productive activity that is based heavily on financial asset prices. "Whereas pre-1980 policy tacitly focused on putting a floor under labor markets to preserve employment and wages, now policy tacitly puts a floor under asset prices."[173] Government bail-outs of large corporations that are highly dependent on financial assets creates a moral hazard in the market by incentivizing over-financialized institutions to involve in mergers and acquisitions in order to reach a scale, which will allow them to shift the costs of failure to the public. An economy with overly-financialized actors sustains policymakers' dilemma between a perceived obligation to prevent systemic collapse by bail-outs, and a definitive feature of prudent governance that allows for the consequences of economic behaviors to be borne by the same actors that are responsible from those actions.

In his review of contemporary capitalism, Acemoglu incorporates contagion theory into his explanation of the recent crisis. He points out that modern finance requires increased connection between financial institutions as a method of risk hedging. While it helps financial institutions to diversify their idiosyncratic risks, widespread distribution of debt obligations across the entire sector increases the systemic vulnerability to less probable tail events with substantial consequences. High

[172] Thomas I. Palley, "Financialization: What It Is and Why It Matters," in *Finance-led Capitalism? Macroeconomic Effects of Changes in the Financial Sector*, ed.s Eckhard Hein et al. (Weimar, Germany: Metropolis Verlag, 2009), 45-6.
[173] Ibid., p. 54.

interconnectedness allows for a domino effect that disseminates individual stresses in financial institutions, households or businesses to the larger economy. “In this light,” the author notes, “perhaps we should not find it surprising that years of economic calm can be followed by tumult and notable volatility.”[174]

Another line of research on the Great Recession focuses on the role income and wealth disparity played in the crisis. An ILO report in 2012 found that “rising income inequality seems to have contributed to the emergence of a credit bubble which eventually burst and triggered the Great Recession.”[175] In an historical account of capitalism since the industrial revolution, Piketty finds that enormous wealth gaps between capitalist and working classes are a descriptive feature of capitalism. Earnings from financial assets significantly outpace the earnings in real wages, and tax priviledges given to higher incomes and inherited wealth –creating a “patrimonial capitalism in which private fortunes are made by unproductive means that contribute minimally to employment generation.[176] Income and wealth disparity and the subsequent pressure on effective demand can be “[…] obscured by a range of demand compensation mechanisms –rising consumer debt, a stock market boom, and rising profit rates,” Palley argues.[177] However, when “these mechanisms are exhausted, […] exits from this impasse […] must be accompanied by measures rectifying the income distribution imbalances at the root of the problem. Absent this, deficient demand will reassert itself.”[178]

De Groot acknowledges the pressure for outsourcing as an endemic feature of neoliberal economics that has substantial consequences on the domestic economy in

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[174] Acemoglu, p. 38.
[175] The International Labor Organization, *Income inequality as a cause of the Great Recession? A survey of current debates*, by Till Van Treeck and Simon Sturn, No.29 (Geneva: ILO, 2012), 24.
[176] Thomas Piketty, *Capital in the Twenty-First Century*, trans. Arthur Goldhammer (Cambridge, MA: Belknap Press, 2014), 112.
[177] Thomas I. Palley, “Economic contradictions coming home to roost? Does the U.S. economy face a long-term aggregate demand generation problem?” *Journal of Post Keynesian Economics* 25 (2002): 9.
[178] Ibid., p. 9.

terms of lost jobs and diminished effective demand, consumption and production. [179] In a free market system that relies on unrestricted mobility of goods, services and factors; economic actors in search of profit-maximization would be inclined to take advantage of cheaper production factors abroad. When one domestic actor shifts its operations to another country to increase its competitiveness, then other participants of the market feel compelled to follow the suit in order to protect their market share. Consequently, outsourcing spreads within the domestic industry –functioning as a phenomenon that is potentially profitable for corporations, but definitely destructive for the labor market in the outsourcing country.

Another type of competitive pressure that has driven the U.S. economy into recession in 2007 was about using risky financial instruments in an effort to protect market share against competition. Michaelson tells the story of Countrywide Financial company before and during the mortgage meltdown to exemplify the organic relationship between capitalism and self-destruction due to the forces of competition.[180] Founded by Angelo Mozilo in 1969, the California-based company had operated as a respectable lender that allowed millions of people realize their dreams of home ownership. However, as the U.S. economy went through a major neoliberal restructuring in the 1980s under the Reagan Administration, a new financial instrument was introduced to the mortgage industry under the name of *subprime loans*. While Mozilo's company initially refused to sell these loans as they were risky obligations with a high likelihood of default, it later had to add this instrument in its portfolio when competitors such as Guardian Savings and Loan, and The Money Store began to claim market share by selling these loans. The decision turned out to be a lucrative one as Countrywide's stock grew by an astonishing 30% a year during the twenty years after 1983 –earning the

[179] Henri L. F. de Groot, "Macroeconomic consequences of outsourcing: An analysis of growth, welfare, and product variety," *De Economist* 149 (2001): 53.
[180] Adam Michaelson, *The Foreclosure of America: The Inside Story of the Rise and Fall of Countrywide Home Loans, the Mortgage Crisis, and the Default of the American Dream* (New York City, NY: Penguin Books, 2009).

company the nickname *23,000% stock*, and Mozilo registered a personal income of $470 million in the 2001-2006 period alone. However, as the toxic loans that allowed this extravagant performance rose to unsustainable levels, they drove the American economy into a historical crash that resulted in Mozilo quitting the company he founded, and a bankrupt Countrywide being rescued by Bank of America in 2008 –ending an instructive episode in American corporate history.

1.2.3 A Critical Outlook on the Literature

Literature on the Great Recession provides valuable insights to academic economists and policymakers to understand various failures that led to the crisis. Nevertheless, various approaches in the current literature are vulnerable against a critical outlook. Political analyses that highlight the roles deregulations and moral hazard played in the crisis lack a policy-relevant insight, and they are speculative by nature. Deregulations argument is a *post-facto* inference that fails to provide a reliable framework to determine the appropriate scale and scope of regulations in various sectors of the economy with an outlook on the future. It adds little to the challenge that trade-offs that exist in a wide array of sectors with distinct characteristics, opportunities and challenges often cannot be estimated analytically in the highly complex and globalized economy of the United States. Accordingly, regulations that seek an optimal balance between growth goals and stability concerns are "evaluated prospectively […] when we know the least about their effectiveness,"[181] as Greenstone observes. The fact that "we cannot know a regulation's benefits and costs until it has been tested [should compel us] to move toward a culture of persistent regulatory experimentation and evaluation."[182]

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[181] Michael Greenstone, "Toward a Culture of Persistent Regulatory Experimentation and Evaluation," in *New Perspectives on Regulation*, ed.s David Moss and John Cisternino. (Cambridge, MA: The Tobin Project, 2009), 123.
[182] Ibid., p. 112.

Studies that pinpoint a number of deregulations in the financial sector as the culprits behind the Great Recession may lead to reversal of some of these destabilizing legislations –but only to encounter new crises in the future due to the regulatory structure's inability to address the changing conditions of an highly globalized U.S. economy. On the other side, considerations of moral hazard created by government bail-outs are speculative as well as sensible. The intensity by which earlier bail-outs may have encouraged excessive risk taking among financial sector executives is practically indeterminable. In the absence of a parameter to help reckon this effect, the argument that the incentives for risk-taking created by bail-outs outweighed the incentives for risk-avoidance created by the threat of losing a lucrative and respectable executive position lacks falsifiability –a core element of scientific inquiry.

Ideological explanations constitute a convincing critique against the free market ideology as distinguishing features of this vision of economics appear closely associated with the failures that led to the crisis. Unrestricted mobility of capital, a debt-based consumption society, deregulated finance, laissez faire governance, income and wealth disparity exacerbated by tax privileges to the wealthy, weakening of social benefits and unionization, and privatizations of essential government functions (Fannie Mae and Freddie Mac, particularly)[183] were at the center of the meltdown in 2007. Nonetheless, these analyses do not address the issue that financial crises and recessions have occurred in the long period before the 1980s when neoliberal policies began to be implemented. In the U.S. economy alone, five economic crises occurred over the 20th Century before the 1980s, and as many major panics and recessions took place in the previous century.[184] Ideological approach that explains the recent crisis with instability created by neoliberal policies over the last three decades has to be supplemented by a more

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[183] Joseph Nathan Cohen and Miguel Angel Centeno, "Neoliberalism and Patterns of Economic Performance: 1980-2000," *The Annals of the American Academy of Political and Social Science* 606 (2006): 36.
[184] John K. Galbraith, *A Short History of Financial Euphoria* (New York: Penguin Books, 1990).

comprehensive outlook that focuses on more fundamental problems that make financial and economic crises a constant feature of capitalist economies.

Perceptions of the financial meltdown as an outcome of disequilibrium levels of the money supply provide a narrative of the dynamics that have occurred prior to the crisis without touching upon the reasons why these dynamics have occurred. Observations of uniform bank behaviors in response to a lax interest rate policy and free international mobility of capital conforms to the *homo oeconomicus* assumption –that economic actors act to maximize their self-interest, however it also ignores the fact that financial institutions other than commercial banks have responded differently to the macroeconomic incentives for risk taking in the economy. Over the period that monetary enticements have provoked commercial banks for excessive risk-taking, cooperatively-structured banks (credit unions) that compete with commercial banks in the same sector by serving the same consumers have not demonstrated any increase in their risk appetite. Subsequently, while commercial banks have suffered tremendously with bankruptcies, public rescues and fire mergers within the context of the financial meltdown; credit union subsector has continued its growth trend in the United States.

The argument that financial crises are corrections to asset overvaluations lacks predictive power. The causal link it establishes between excessive rises in commodity values and financial crises appeal to intuition as well as being supported by empirical data. However, it does not explain sustainability of the factors behind the bubbles given that it is often known to informed observers that valuations in subject markets have not been explainable by economic fundamentals for long time. As Claessens and Köse note, "Many theories focusing on the sources of crises have recognized the importance of booms in asset and credit markets. However, explaining why asset price bubbles or credit booms are allowed to continue and eventually become unsustainable and turn into busts or crunches has been challenging."[185] By not drawing the line between *valuations* for which capitalism strives and overvaluations that precede economic catastrophe, proponents of the bubbles hypothesis to explain financial crises submit to an ideology that promotes nonintervention of the state in bubble markets due to a dogmatic belief in the correctness of market prices. This approach leaves explanations of financial crises with asset overvaluations after the fact vulnerable against the problem of *selection bias*, which compromises scholarly supportability of the bubbles hypothesis.

Analyses with a systemic outlook persuasively acknowledge a number of dynamics interwoven with capitalist ways of organizing production, distribution, ownership and finance; however, they also appear incapable of escaping from a false dichotomy between capitalism and socialism. They attribute observed problems to "capitalism" without addressing the possibility that a particular version of capitalism that has been analyzed could consist of dynamics distinct to its own form. Consequently, emphases on economic behavior –in their Minskian, Keynesian, Schumpeterian or Marxian forms- have been uniformly built on an oversimplified assumption that the purpose of economic behavior consists solely of profit-maximization in capitalism. This approach ignores other forms of economic rationale such as non-profit purpose (profit-making for the business rather than profit-maximizing for the owners) or stakeholder-ownership (ownership and management by those who are impacted from the business' operations -rather than ownership by detached stockholders and management by professional executives). With this gap, systemic explanations of the Great Recession speaks to a number of vulnerabilities in commercial businesses that led to the crisis, but they do so without offering a reformist position to the current capitalist system that goes beyond the narrow discussions of socialism as a systemic alternative.

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[185] Stijn Claessens and M. Ayhan Köse, "Financial Crises: Review and Evidence," *Central Bank Review* 13 (2013): 3.

Next section presents an additional angle to discussions of financial crises. Organizational rationality embedded in the structure of economic organizations is considered as an analytical element that is potentially consequential for organizational stability.

1.3 An Alternative Institutionalist Approach: Organizational Rationale

This section addresses the above-mentioned shortcomings by examining the potential of cooperative rationality as a promoter of stability in contemporary political economy. It criticizes the common conceptualization of rationality along the lines of the *home oeconomicus* axiom, and argues that this invariance distracts institutional economics from focusing on the core institution in economics: business organizations. Cooperative rationale is put forth as an alternative form of organizational purpose –one with a capacity to endorse institutional stability. The section presents an overview of the theory of cooperativism, historical conditions that led to its rise in the 19th Century, and the conceptual framework it adds to the discourse on financial stability. Six distinguishing characteristics of cooperative organizations are identified as the constituents of the cooperative context that incentivizes stability among economic actors. Lastly, limitations of the cooperative model are discussed to account for practical instrumentality of cooperative rationale in contemporary political economy.

1.3.1 Rationality Assumption in Economic Analysis

This section questions the treatment of *homo oeconomicus* axiom as an *a priori* knowledge in the current literature on the Great Recession. It puts forward context as a more aggregate influence on economic behavior, and acknowledges *homo oeconomicus* as a model that accurately depicts economic behavior only when the context of the observed economic actors is a context of commercial motivations. As Clark and Wilson put, “the theory […] locating perspective transformation within the individual and predicated upon humanistic assumptions of a decisive, unified self fails to explore the constitutive relationship between individuals and the sociocultural, political and historical contexts in which they are situated."[186] Contextual reality influences behavior, which compromises the reliability of profit-maximization as a preordained purpose of economic activity in explanations of empirical economic outcomes.[187] Changing contexts motivate decision makers to reassign weights to material considerations at each decision node on a continuous basis. Accordingly, "[…] beliefs, desires and preferences that count as rational may change from one deliberate context to another, [… because they] are constructed on a case to case basis, and are distinct from the agent's stable set of background attitudes."[188]

Rationality of a behavior is validated by the context in which it occurs, and decision maker's awareness of reasons or calculations of effectiveness of the decision is less relevant to this descriptive process.[189] Manski identifies three dynamics that are influential on social behavior: "1) *endogenous interactions,* wherein the propensity of an agent to behave in some way varies with the behavior of the group; 2) *contextual interactions,* wherein the propensity of an agent to behave in some way varies with exogenous characteristics of the group members; 3) *correlated erects,* wherein agents in the same group tend to behave similarly because they have similar individual characteristics or face similar institutional environments."[190] Common denominator in these patterns of social interaction is that they rely on individuals reproducing a rational choice for themselves based on an evaluative process of exploring behaviors that best serve their interest as social actors in given conditions.

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[186] M. Carolyn Clark and Arthur L. Wilson, "Context and Rationality In Mezirow's Theory of Transformational Learning," *Adult Education Quarterly* 41 (1991): 90.
[187] George A. Akerlof & Rachel E. Kranton, *Identity Economics: How Our Identities Shape Our Work, Wages, and Well-Being* (Princeton, NJ: Princeton University Press, 2011).
[188] Brian Kim, "The Context-Sensitivity of Rationality and Knowledge" (PhD diss., Columbia University, 2012).
[189] Barbara Townley, *Reason's Neglect: Rationality and Organizing* (New York City: Oxford University Press, 2008).
[190] Charles F. Manski, "Economic Analysis of Social Interactions," *The Journal of Economic Perspectives* 14, no. 3 (2000): 127.

The supposition that preferences are adaptive, localized, manipulable constructs that are shaped by contexts[191] is consistent with previous assumptions on decision-making that have been introduced. It is an inclusive assumption that emphasizes *context* as the common independent variable behind the assumptions that individuals are behaviorally mobilized by irreversible spiritual intentionality (*homo religiosus*), desire for social acceptance (*homo sociologicus*), innate affinity to regularities (*homo habitus*), virtue-inclusive selfishness (*homo moralis*), and finally, non-normative selfishness (*homo economicus*).[192] This approach is also consistent with the assumption of *bounded rationality*, which sheds light on practical hindrances to rational decision-making such as insufficient information, time pressures or cognitive limitations; however it departs from the bounded rationality perspective with its full (rather than partial) emphasis on factors outside (rather than inside) of the human mind (contextual reality).[193]

The argument for the role of context on behavior provides that economic actors are innately capable of seeking their own interest in a socially responsible way if and when their contextual environment incentivizes it. Organizational contexts provided by businesses in which individuals act in the capacities as owners, workers, managers, vendors or patrons influence their cognition of choices as decision makers.[194] Accordingly, examining the link between organizational rationality of commercial, stockholder-owned and board-controlled financial corporations and their risk tolerance would be a promising endeavor to get a sense of the failures that led to the financial crisis in 2007. In this analysis, not-for-profit, stakeholder-owned-and-controlled

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[191] Amos Tversky, Shmuel Sattath and Paul Slovic, "Contingent weighting in judgment and choice," *Psychological Review* 95 (1988): 371-84.
[192] Joseph Schumpeter, *The Economics and Sociology of Capitalism* (Princeton, NJ: Princeton University Press, 1991), 336.
[193] Wolfgang Streeck, Michael Piore and Amitai Etzioni, "Bounded Rationality," *Socio-Economic Review* 8 (2010): 377-97.
[194] Petri Ollila, "Principles of Institutional Economics -with Applications to Cooperative Enterprises," (working paper, Department of Economics, Helsinki University, Helsinki, 2004), http://www.helsinki.fi/taloustiede/opiskelu/mark/Principles%20of%20institutional%20economics.pdf.

cooperative banks (credit unions) would constitute an instructive contrast to commercial banks –with a potential to reveal commercial rationality as an intrinsic instability factor in them.

1.3.2 Cooperative Rationale as an Alternative Assumption

Since its inception in economic sphere in the mid-19th Century, cooperative rationale as a base for business organization has provided an incontrovertible competition to commercial mentality. The sentiment of democratization and liberalization from authority in the aftermath of the French Revolution, need for solidarity among the rural people in the urban areas where they had to relocate, and farmers' increased need for cheaper machinery and inputs in the post-feudal economy paved the way for cooperativism in the face of industrialization. In the 20th Century, these motivations were complemented by individual economic actors' desire to claim a larger share in the proceeds of their productive activities, reach out larger markets by means of a larger marketing function, and protect against an increasing threat from monopolization among commercial competitors. Cooperative movements have consistently grown in number and significance around the world reaching 1 billion members,[195] 250 million employees and a turnover of $2.2 trillion[196] in 2012 designated by the UN as "the International Year of Cooperatives".

Examining the link between organizational type and risk tolerance has consistencies with both strands of the *institutional economic* approach to social analysis (*original* and *new institutional economics*). Institutional economics was established as a coherent school of thought in the 20th Century with the earlier works by Thorstein Veblen, Wilhelm Roscher (and the followers of the German Historical School of

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[195] World Watch Institute, "Membership in Co-operative Businesses Reaches 1 Billion," accessed January 16, 2015, http://www.worldwatch.org/membership-co-operative-businesses-reaches-1-billion-0.
[196] International Cooperative Alliance (ICA), "Facts and Figures," accessed January 16, 2015, http://ica.coop/en/facts-and-figures.

Thought he founded), John R. Commons and Wesley C. Mitchell. Furthered by writers such as John K. Galbraith, Gunnar Myrdal, François Perroux, Robert H. Frank, Anne Mayhew, Mark Tool, Rick Tilman and Warren J. Samuels in following decades, institutional economics was distinguished from the neoclassical orthodoxy with its fundamental rejection of the perception that economy is an autonomous structure that is independent from social and political forces. Institutionalism recognizes social forces to be mutually dependent on each other, and examines the tangible ways institutions such as legal system,[197] culture, technology, politics, psychology and evolution facilitate this interactive process. It abandons simplified assumptions neoclassical theorists have conventionally used to model economic phenomena econometrically,[198] and relies on inductive reasoning based on empirical data instead. While "[…] neo-classical theorists start with postulates and reason therefrom, institutional theorists start with facts –or a selection of supposedly relevant facts" and mold them into a theory that generalizes their revelations.[199] Institutional economists emphasize the interaction between the individual and the society in making their case for the roles normative values and social expectations play in economic behavior, and embrace a distinct assumption of rationality that separates them from both *neoclassical* and *new institutionalist* lines of thinking. While neoclassical models rely on an assumption of a perfectly rational economic actor who maximizes his self-interest (*homo economicus*) and new institutional observers argue for an imperfectly rational economic actor whose pursuit of rational choice is restricted by informative, cognitive and time limitations (*bounded rationality*); original institutional economists emphasize that social, political and economic circumstances

[197] Dani Rodrik, Arvind Subramanian and Francesco Trebbi, "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development," *Journal of Economic Growth* 9 (2004): 131-65.
[198] Petri Ollila, "Principles of Institutional Economics -with Applications to Cooperative Enterprises," (working paper, Department of Economics, Helsinki University, Helsinki, 2004), http://www.helsinki.fi/taloustiede/opiskelu/mark/Principles%20of%20institutional%20economics.pdf.
[199] W. H. Kiekhofer et al., "Institutional Economics," *American Economic Review* 22 (1932): 107-8.

influence individuals' decision making processes –a core assumption in the present essay.[200]

In addition to sharing original institutional economics's perception of rationality as a circumstantially-determined phenomenon, the analysis of organizational structure as an influence on organizational behavior is consistent with new institutional economics's consideration of the *firm* as a primary analytical unit. Following a seminal paper on transaction costs by Ronald Coase in 1960,[201] Oliver Williamson, Douglas North and Mancur Olson examined cost implications of various changes on economic institutions –forming *new institutional economics* as a distinct scholarly tradition.[202] Although their conceptualization of institutions and transaction costs is criticized to be overly static[203] and subjective,[204] their argument that positive economic performance is a function of efficient institutions with lower transaction costs in gathering and processing information, negotiating terms of business, coordinating various components of business, and enforcing contracts shed light on the internal workings of business organizations as an influential *institution* on the larger society.[205]

As an organizational form, cooperatives have been a focus of analysis in new institutional economics.[206] Reflecting transaction costs concern of this school of thought, a number of observers have analyzed efficiency aspects of cooperatives in order to draw

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[200] Jairo J. Parada, "Original Institutional Economics and New Institutional Economics: Revisiting the Bridges (Or the Divide)," *Oeconomicus* 6 (2002): 45 and Mehmet G. Şenalp, "Dünden Bugüne Kurumsal İktisat [Institutional Economics from Yesterday to Today]," in Kurumsal İktisat [Institutional Economics], ed. Eyüp Özveren (Ankara: İmge, 2007), 84.
[201] Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economic* 3 (1960): 1-44.
[202] Kenneth Scott, "Bounded rationality and social norms," *Journal of Institutional and Theoretical Economics* 150 (1994): 316.
[203] Ha-Joon Chang, "Institutions and economic development: theory, policy and history," *Journal of Institutional Economics* 7 (2011): 494.
[204] Pranab Bardhan, "The New Institutional Economics and Development Theory: A Brief Critical Assesment," *World Development* 17 (1989): 1394.
[205] Parada, 50.
[206] Thomas Bauwens, "New institutional economic theories of non-profits and cooperatives: a critique from an evolutionary perspective" (paper presented at the 4th EMES International Research Conference on Social Enterprise, Leige, Belgium, July 2013).

stylized inferences about cooperatives' ability to reduce various transaction costs. Levi noted that cooperatives' descriptive feature to constrain profit redistribution makes them less likely to exploit informational advantages they have in the markets with imperfectly distributed information.[207] Hansmann predicted that relevance of cooperatives that rely on equal distribution of voting power will be challenged in the future as patrons' interests have been increasingly more heterogeneous, but only to be restored by contractual induction of homogeneity in interests. He cited increasing international significance of Visa and Mastercard companies, both of which are cooperatives owned and controlled by their member banks whose interests have been unified within a contractual framework.[208] Spear identifies a number of organizational features that deem cooperatives more advantageous to the commercial alternatives for consumers, investors and the society. He notes that these factors are cooperatives' proximity to community needs (due to their status as quasi-public entities), lower transaction costs from monitoring (due to a higher perceived trustworthiness), "higher capability to manage contract and governance failures" (due to their business model based more on relationships than industry standards), and larger contributions to social efficiency (due to their positive externalities).[209] Other new institutional studies on cooperatives focus on issues such as the relationship between workers' inability to diversify their risk and productivity,[210] or "workers' horizon problem" –propensity to underinvest due to high cost of capital[211] -complementing the cooperativist literature built outside of the institutionalist paradigm.[212]

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[207] Yair Levi, "How nonprofit and economy can co-exist: A cooperative perspective" (paper presented at the ICA XXI International Cooperative Research Conference, Cork, Ireland, August 2005).
[208] Henry Hansmann, "Cooperative Firms in Theory and Practice," *Finish Journal of Business Economics* 48 (1999): 402.
[209] Roger Spear, "The Co-operative Advantage," *Annals of Public and Cooperative Economics* 71 (2000): 522.
[210] Michael C. Jensen and William H. Meckling, "Rights and Production Functions: An Application to Labor-managed Firms and Codetermination," *Journal of Business* 52 (1979): 469-506.
[211] Eirik G. Furubotn, "Property rights and the behavior of the firm in a socialist state: The example of Yugoslavia," *Journal of Economics* 30 (1970): 431-54.
[212] A few leading works in this tradition are Richard Wolff, *Democracy at Work: A Cure for Capitalism* (Chicago, IL: Haymarket Books, 2012); Steve Dubb (ed.), *Building Wealth: The New Asset-based Approach to Solving Social And Economic Problems* (Washington, DC: Aspen Institute, 2005); and Gar

Remainder of this essay presents an outline of cooperativism as an economic theory, historical and intellectual conditions that led to its emergence, and the conceptual framework it offers to analytical assessments of stability in contemporary political economy.

1.4 Cooperativism: A Historical Response to Commercialism

Cooperatism is "[…] a political ideology, economic theory and form of government […] that aims to create conditions in society which are deemed favorable to collective ascension."[213] Its manifestation in economic sphere is widely called *cooperative economics*, which covers economic analyses of cooperatist ideas such as public transportation vs. individually-owned vehicles, apartment living vs. stand-alone houses, social security system vs. alternative means of insurance, worker-owned businesses vs. stockholder-owned corporations, or time banking vs. fiat money exchange in communities. Central to cooperative economics are the distinct organizations called *cooperatives*, which are "organizations owned and run jointly by their members who share their profits or benefits."[214] Theoretical studies and practical applications of cooperatives constitute the body of knowledge and social movement called *cooperativism,*[215] which builds on the insights provided by *cooperativists* –experts who possess theoretical and/or practical knowledge on these organizations[216].

Alperovitz, *America Beyond Capitalism: Reclaiming Our Wealth, Our Liberty, and Our Democracy* (Hoboken, NJ: John Wiley & Sons, 2006).

[213] *Encyclopedia Ardenica*, online ed., s.v. "Cooperatism."

[214] *Oxford Dictionaries*, online ed., s.v. "Cooperative."

[215] Carl Ratner, "Cooperativism: A Social, Economic, and Political Alternative to Capitalism," *Capitalism Nature Socialism* 20 (2009): 44-73.

[216] This dissertation follows the terminological classification used in international sources such as the EU-sponsored ID-COOP project (http://www.id-coop.eu/en/KeyConcepts/Pages/Cooperativism.aspx), and uses the term *cooperativism* instead of *cooperation*, and *cooperativist* instead of *cooperator* in order to distinguish the distinct organizational form of *cooperatives* from the common connotation attached to the word *cooperation*. Nonetheless, it may also cite resources that use these terms interchangeably.

While the idea of cooperating to serve common interests is believed to be as old as human history, cooperativism in the sense of establishing a formal set of guidelines to work cooperatively can be traced to the late 15th Century Netherlands. Established in 1489, a porters' collective named *The Shore Porters Society* has become the first business in history that was established out of collective purpose of its members.[217] In 1736, first cooperative in America, *Union Fire Company*, was founded in Philadelphia as an association of mutual assistance among various firefighting companies.[218] French cheese-makers' cooperative *Frutieres* (est. 1750), Greek weavers' cooperative *Red Yard* (est. 1780) and Italian dairy farmers' cooperative *Osoppo* (est. 1806) became the earliest cooperatives in Europe.[219]

Intellectual foundation of cooperativism as a coherent body of knowledge has been credited to the writings of the 19th Century businessmen Robert Owen, William King and Charles Fourier. Prominent industrialists who envisioned a socialist society to improve dire conditions of laborers within the context of the Industrial Revolution; Owen, King and Fourier rejected individualism, competition, market economics, private property and organized religion, and advocated establishment of communal villages with collectively-operated farms and factories. They have laid out explicit accounts of their vision,[220] and convinced their wealthy contemporaries to finance the world's earliest cooperative work village projects in New Harmony, Indiana; Orbiston, Scotland; Ralahine, Ireland and Queenswood, England in the early 1800s. [221] Inspired by these cooperative villages and the writings of Owen and Smith published in the Co-operator

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[217] Tim Mazzarol, Elena M. Limnios and Sophie Reboud. "Cooperative enterprise: a unique business model?" (paper presented at the 25th Annual ANZAM Conference, 7-9 December 2011, Wellington, New Zealand).

[218] William Shurtleff and Akiko Aoyagi, *History of Cooperative Soybean Processing in the United States: Bibliography and Sourcebook* (Lafayette, CA: Soyinfo, 2008), 102.

[219] Jack Shaffer, *Historical Dictionary of the Cooperative Movement* (Lanham, MD: Scarecrow Press, 1999), 242, 271.

[220] For instance, Fourier wrote that cooperative villages, which he called *phalanxes*, should have 1,000 to 1,800 people in three square miles in order to become effective.

[221] Kimberly A. Zeuli and Robert Cropp, *Cooperatives: Principles and practices in the 21st century* (Madison, WI: Cooperative Extension Publishing, 2004), 7.

magazine, a small group of people established the world's first consumer cooperative in Rochdale, England in 1833. Even though the store, which was founded to provide cost-priced consumer goods to its members and jobs to unemployed locals failed in two years, it was reopened in 1844 under the name *Rochdale Society of Equitable Pioneers*. Lessons from the first attempt drove the 28 founders of the second store to design its operational structure more comprehensively, and the foundational manifesto of this store has been adopted as the universal principles of cooperatives still used to identify cooperatives around the world today (discussed in the next section).[222]

French political liberalism and Christian socialism were two major ideological currents that impacted the foundation of cooperativism. Philosopher Charles Fourier (1772-1837), historian Louis J. J. C. Blanc (1811-1882), sociologist Philippe J. B. Buchez (1796-1865) and historian Charles Gide (1847-1932) in France have developed the concept of *colloborative production* while German politicians Wilhelm Haas (1839-1913) and Friedrich W. Raiffeisen (1818-1888) introduced the idea of *cooperatives' banking* and used it to establish *rural development/agricultural cooperatives*. Legist Ferdinant Lassalle (1825-1864) wrote some of the earliest writings on political economics of cooperativism as he advocated for *government-sponsored producers' cooperatives* to alleviate poverty. Former Prime Minister of Italy Luigi Luzzatti (1841-1927) and Irish writer and senator Sir Horace Blunkett (1854-1932) had contributions in the fields of *agricultural credit cooperativism* and *dairy cooperativism*, respectively. Danish pastor and philosopher Nikolai Grundvig (1713-1872) started agricultural cooperativism in Scandinavia with his pioneering works that introduced the notion of *adult education*. German economist Franz H. Schulze-Delitzsch (1808-1883) and social

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[222] Brett Fairbairn, "The Meaning of Rochdale: The Rochdale Pioneers and the Cooperative Principles," (working paper, Center for the Study of Cooperatives, University of Saskatchewan, Saskatoon, 1994), http://usaskstudies.coop/pdf-files/Rochdale.pdf.

reformer Victor A. Huber (1800-1869) have contributed the cooperative theory with *purchasing cooperatives* and *housing cooperatives* as unique cooperative forms.[223]

Cooperative movements' rise in the West in the first half of the 19th Century was followed by the first cooperatives in middle-income countries in the second half of the century (Brasil-1847, Hungary-1850, Portugal-1853, Russia-1860, Turkey and Bulgaria-1863, Romania-1887). In pre-war 20th Century, cooperative movements began mostly in agricultural sectors in colonized dominions (South Africa-1902, Cyprus-1909, Senegal-1910, Tayland-1917), and in the interwar years in socialist countries (U.S.S.R.-1919, Zaire-1921, Cuba-1943). While cooperatives sustained their significance both in capitalist and socialist spheres for the following two decades, they have begun to be marginalized upon the conclusion of the Cold War in 1981 when the Soviet Union dissolved. Capital-oriented neoliberal policies (such as elimination of tax advantages or agricultural subsidies) since then have effectively pushed cooperativism to the periphery of mainstream economics. Nonetheless cooperative movement has quietly continued to grow on a global scale –making cooperative enterprise the business model that is projected to grow fastest by 2020.[224]

Historical trajectory of cooperativism can be explained by a number of correlated forces.[225] First of these forces is the presence of *market failures*. When economy fails to provide goods and services affordably as a result of monopolization, market gluts and underdevelopment, people who are negatively impacted these conditions take the initiative and pool their resources to reverse the adverse effects. History of rural electricity in America exemplifies this dynamic. As the federal government built transportation networks around the country after the WWII, a wave of suburbanization

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[223] Johnston Birchall, *The International Co-Operative Movement Hardcover* (Manchester, UK: Manchester University Press, 1997).
[224] "Cooperatives to be the fastest growing business model by 2020," Business Alliance for Local Living Economies, accessed November 09, 2014, https://bealocalist.org/cooperatives-be-fastest-growing-business-model-2020.
[225] Zeuli and Cropp, 15.

began in the United States in the late 1950s. However, newly established communities found their less-populated new towns neglected by the government in terms of investments in infrastructure, which were generally considered unfeasible due to low population of suburban and rural communities. Their common need for basic utilities drove them to establish cooperatives and serve their own needs privately. Today, 95% of rural electricity in America is provided by local cooperatives that are owned and controlled by local citizens.[226]

Economic crises have been another factor that historically mobilized consumers towards cooperation. When financial hardships set in as a result of increased unemployment and indebtedness, consumers are inclined to establish cooperatives to satisfy their food needs at a near-breakeven level. 92% of all cooperatives in the world's most prosperous economy remain to be consumer cooperatives today.[227] A third factor that supports the growth of cooperative movement has been *technological change*. As new technology penetrates an economy, areas that are based on the discarded (old) technology suffer economically. Rise of cooperativism in Detroit, which fell from being the world's most prosperous city in terms of per capita income to one of the most impoverished in America today as a result of neoliberal policies (mainly NAFTA that shifted automotive factories to Mexico) and American automobile manufacturers' inability to compete with low-MPG technologies in Asian competitors makes an example of this condition.[228] Other factors that influenced the strength and scope of cooperative movement are financial and political ability of *farm organizations and cooperative advocates* to influence policymaking, and *ideological tendencies* of judicial decision makers and elected political leaderships at state and national levels.

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[226] Ayhan Tan and M. Hadi İlbaş, *Enerji Sorunu ve Çözümleri* [The Energy Issue and Its Remedies] (Ankara, Turkey: Harman, 1996), 7.
[227] Mark J. Kaswanab, "Developing democracy: cooperatives and democratic theory," *International Journal of Urban Sustainable Development* 6 (2014): 203.
[228] Emily Canosa, "Worker cooperatives: Taking ownership of our economy," *Critical Moment*, October 28, 2012, accessed November 09, 2014, http://critical-moment.org/2012/10/28/worker-cooperatives-taking-ownership-of-our-economy-2/.

1.4.1 Conceptual Framework

Cooperatives are special forms of organization that are distinct from their commercial competitors in six fundamental features: their sophisticated perception of profits, inclusive description of beneficiaries, idea of member executives, sensitivity to community interests, emphasis on sustainability, and empowerment of the individual. These characteristics are constituent elements of cooperatives' capacity to create contexts of social responsibility for their executives. As Levi and Pellegrin-Rescia acknowledge, cooperatives are "[…] the only form of corporate entity with a clear entrepreneurial component where the subordination of the economic to the social is inherent in the logic of the organization and is usually stipulated by law."[229] Peculiar socioeconomic context they create give cooperatives a unique character as organizations that are "[…] too socially focused to fit comfortably within the mainstream economic structures of the investor owned firm (IOF), but remain too economically focused for the non-profit sector."[230] Descriptive elements of the conceptual framework in cooperativism are discussed in the following sections.

1.4.1.1 Concept of *Surplus*

A primary conceptual difference between cooperatives and corporations is their perceptions of *profits*. Capitalist businesses exist to maximize their profits in order to maximize returns for their investors. Cooperatives exist to serve their members, and they perceive profits only as a means to remain in business so they accomplish this goal. Accordingly, cooperatives are described as *not-for-profit* (maximizing) organizations[231]

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[229] Yair Levi and Marie Louise Pellegrin-Rescia, "A New Look at the Embeddedness/Disembeddedness Issue: Cooperatives as terms of reference," *Journal of Socio-Economics* 26 (1997): 160.
[230] Mazzarol et al.
[231] This classification is close to, but different from the concept of non-profit organizations. While *not-for-profits* and *non-profits* are both established to serve the public good without aspiring to maximize profits, *non-profits* are not owned by individuals, and they are legally required to add their profits into their next

in which "individuals pool their capabilities in order to perform activities they cannot do as effectively by themselves, and do so for a price at the cost level."[232] Due to this fundamental difference between cooperatives that operate to minimize their profits and corporations that work to maximize them, cooperativism avoids the term *profits*, and uses *surplus* instead. While this term has connotation with Marxian thought that popularized it, cooperativist theory is neither as hostile to profits as Marxism is nor as preoccupied with them as neoclassical capitalism is.

This perception of profits marks a stark contrast with the approach in commercial organizations. For-profit (maximizing) corporations are owned by their shareholders who finance their operations via stock ownership or equity share. Because shareholders become owners to a company for the sole purpose of maximizing their returns on investment, corporate boards that are appointed by shareholders work to maximize their companies' share values. Profit maximization that supports this goal (along with expectations management/speculation for publicly trading companies) becomes the primary purpose of existence for these businesses. As Friedman openly observed, "there is one and only one social responsibility of business –to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud."[233]

A landmark lawsuit in 1919 has certified the essentialness of profit maximization motive in commercial corporations. In *Dodge v. Ford Motor Company*, Michigan Supreme Court ruled that Henry Ford's usage of some of Ford's profits for community service and job-creating investments violated fundamental rights of the company's

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operational budget. *Not-for-profits* (cooperatives), on the other hand, are owned by their members (if jointly), and they can deliver their profits to their members according to their patronage (contribution to the co-op).

[232] Ziya Gökalp Mülâyim, *Kooperatifçilik* (Ankara: Yetkin, 2010), 72.

[233] Friedman (1962), 133.

shareholders to receive those funds for personal gain.[234] Other similar cases such as *IAP Smith Manufacturing Co v. Barlow* (1953) and *Shlensky v. Wrigley* (1968) have further sustained the perception of profit maximization as an inalienable purpose of a business. While this motivation could be legitimate for a for-profit enterprise, it also spells the dissociation of social responsibility from the administrative logic that governs commercial businesses. Moral gap displayed by companies that pollute environment to improve their bottom line confirms this problem. When environmental protection laws are weak or unenforceable, dumping hazardous waste to nature rises to be an attractive option to corporate leaderships in pursuit of profit maximization. This move would be perfectly "rational" (as defined in neoclassical economics) as it benefits them directly and strongly (expense reduction) while harming them indirectly and weakly (longer-term environmental damage shared by thousands of other people in the area). As von Ravensburg frankly puts, the safest and most legitimate path a business executive can take is to have his/her organization to behave in a socially apathetic way.[235]

1.4.1.2 Concept of *Stakeholder*

Stakeholder is another concept that distinguishes cooperatives from commercial organizations. Cooperatives are owned by their users (or workers in the case of worker coops) who, by their very relationship to the coop, are *stakeholders* whose interests are served by the operations of cooperatives. On a broad taxonomy that classifies cooperatives into four main categories, these stakeholders can be workers of the co-op (in *worker co-ops*), consumers of the goods or services provided by the co-op (*consumer co-ops*), producers that provide goods or services to the co-op (*producer co-ops*), or

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[234] Julie A. Nelson, *Economics for Humans*, trans. Didem Kizen (Chicago: The University of Chicago Press, 2006), 94.
[235] Von Ravensburg, Nicole G. "Economic and Other Benefits of the Entrepreneurs' Cooperative as a Specific Form of Enterprise Cluster," International Labor Organization, 2010. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_173050.pdf, (accessed February 2013).

businesses that benefit from the services of the co-op (*entrepreneurial co-ops*[236]). The stakeholder feature links co-ops organically to their communities, and encourages co-op managers to adopt sustainable, risk-averse and socially responsible policies. Because cooperatives' organizational goal is service to stakeholders, their managers are assessed based on the extent to which their organizations satisfy this purpose. This structure builds on the *stakeholder theory* of corporate governance, which argues that businesses "have more extensive duties to key stakeholder groups like employees, communities, customers, suppliers, and so on, than is strictly required by law."[237]

1.4.1.3 Concept of *Active Property*

Distinct ownership structure in cooperatives is a response to the ownership style in modern corporations that discredits the assumptions for fairness and empowerment in capitalist supposition. Cooperatives rely on the notion of *active property,* which refers to (partial) ownership of managers in an enterprise. Corporations, on the other hand, embraces *passive property*, which translates into stock equity detached from any responsibility or managerial authority in the firm.[238] While "company" was an enterprise in which active and passive property accumulated in the same owner or owners in the 18th Century England when Adam Smith conceptualized his notion of "private property," modern corporations no longer includes this feature. In the 21st Century corporation, owners exist as a separate class from the management, and they function solely as a source of capitalization for the business. Manner points out that "when they [active and passive property] attach to different individuals, private property in the

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[236] Von Ravensburg, Nicole G. "Economic and Other Benefits of the Entrepreneurs' Cooperative as a Spesific Form of Enterprise Cluster," International Labor Organization, 2010. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_173050.pdf, (accessed February 2013).

[237] Joseph Heath, "Stakeholder Theory, Corporate Governance and Public Management: What can the history of state-run enterprises teach us in the post-Enron era?" *Journal of Business Ethics* 53 (2004): 249.

[238] Mikko H. Manner, "The Impact of Other-regarding Behavior and Bounded Rationality on Decision Making and Corporate Social Performance" (PhD diss., Rensselaer Polytechnic Institute, 2009).

instruments of production disappears, and the driving motivation behind the theoretical efficiency of the invisible hand guided by self-interest is suspect."[239]

Merits of the notion of *collective private ownership* has been acknowledged by a diverse range of observers. Founder of the Chicago school of economics -a bastion of free market ideology, Henry C. Simons noted in 1948 that "turned loose with inordinate powers, corporations have vastly overorganized most industries. America might now be better off if the corporate form had never been invented or never made available to private enterprise."[240] Another prominent name in supply-side economics, Friedrich von Hayek concurred that "if we continue on the path we have been treading [towards what he called 'the monopolistic organization of industry' closely linked to the government], it will lead us to totalitarianism."[241] These concerns have also been shared by an increasingly larger portion of the U.S. society, which reveals increasing wariness about corporate power in public opinion polls.[242]

Stiglitz recognizes a heightened sense of social responsibility as a competitive advantage for cooperatives in the age of globalization. He contends that globalization increases –rather than decreases- cooperatives' relevance as small businesses that are challenged by extraordinary distribution networks, negotiation powers and scale economies of large MNCs in a free trade environment would be compelled to cooperate with one another in order to remain competitive. He attributes the remarkable performance of the Italian economy prior to the 2000s to the larger role given to cooperatives in supporting small businesses, and cooperatives' functionality to the larger capacity to endorse social responsibility: "[… One] of the reasons for Italy's success in

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[239] Ibid., 20.
[240] Henry Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948), 34.
[241] Friedrich von Hayek, *The Road to Serfdom: With the Intellectuals and Socialism* (London: Institute of Economic Affairs, 2005), 194-5.
[242] Survey respondents who said that "they had a great deal of confidence in major corporations" dropped from 55% in the 1960s to 21.5% in the 1970s and to 13% in the early 2000s. Source: Gar Alperovitz, *America Beyond Capitalism: Reclaiming Our Wealth, Our Liberty and Our Democracy* (Hoboken, NJ: John Wiley & Sons, 2005), 174.

recent decades is that it has developed an almost unique institutional framework for addressing the common needs of the small and medium sized enterprises –the cooperative movement. […] cooperatives have been at the centre of many of the most successful developments, and have succeeded in bringing together sound management and fiscal discipline with broader social perspectives."[243]

1.4.1.4 Concept of *Social Responsibility*

Another distinguishing feature of the cooperative framework is the idea of social responsibility as an ontological purpose of an organization. While, in commercial businesses, social responsibility appears consistent with the organizational purpose only when it serves the material interests of business owners (tax advantages, public image, etc.), it is omnipresent as a foundational reason and a descriptive feature in cooperatives.[244] In the United States, when a co-op's income exceeds its expenses at the end of a fiscal period, around 10% of the difference is put back in the co-op's reserve fund established to sustain the co-op's operations, another 10% of it is set aside to provide continuing education to members so they remain supportive of cooperative values and improve their professional skills, and a third piece is spent for community improvement projects in the area where the co-op is located. Finally, the remaining amount is distributed to the members as patronage refund that functions like an interest return on their investments in the co-op, which are initial membership fee and annual dues. This profit distribution scheme is a unique formula that combines the concept of *dividend payments* in publicly trading corporations, and the concept of *profit reappropriation* in non-profit organizations.

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[243] Stiglitz, Joseph. "The Role of Cooperatives in Globalisation" University of Genova Working Paper No. 9/2004, 2004. http://www.caledonia.org.uk/papers/role-of-cooperatives-in-globalisation.pdf, (accessed March 10, 2014).

[244] "Factsheet: Differences between Co-operatives, Corporations and Non-Profit Organisations," accessed February 13, 2013, http://ica.coop/sites/default/files/Factsheet%20-%20Differences%20between%20Coops%20Corps%20and%20NFPs%20-%20US%20OCDC%20-%202007.pdf.

Cooperatives' local identity further encourages social responsibility. Because co-ops are owned and operated by their workers, producers or consumers; they, by definition, attract local people as members. Accordingly, serving members' common interest unavoidably translates into serving the *local interest*, which leads to a socially responsible management culture. In a co-op, board members are elected by the co-op's members from among themselves. They serve on a rotating basis in order to prevent concentration of power and disconnect between management and workers. They are not compensated in addition to their regular income from the co-op so management does not break out of the co-op as a distinct class with potentially-conflicting interests. Executives are appointed by the board and they can be non-members who are compensated with a salary or members who work on a voluntary basis (In the U.S., some co-op executives such as credit union directors are not legally allowed to be compensated).[245] However, the board of directors, which consists of the co-op's members, provides them the general direction and evaluates their judgments about how to accomplish desired outcomes.[246] This system, which assures that executives run the co-op committed to its social principles, differs from the board-management relationship in corporations where current board nominates and elects new board members with minimal involvement of the shareholders, but for the ultimate purpose of serving the interests of the shareholders. As indicated by the word *co*operative, the culture of collective work and purpose is the distinguishing feature of cooperatives in the business world.

The notion of *localness* emphasizes a long-forgotten purpose in economics: sentimental satisfaction. Despite the fact that neoclassical theory systematically

[245] Brent Hueth and Philippe Marcoul, "Incentive Pay for CEOs in Cooperative Firms," SSRN discussion paper (November 17, 2008): 4. http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1303050_code337270.pdf?abstractid=1303050&mirid=1

[246] The U.S. Department of Agriculture, "Co-ops 101: An Introduction to Cooperatives." http://www.rurdev.usda.gov/supportdocuments/cir55.pdf

positions economics as a study of *efficiency*, the ultimate purpose in economic inquiry remains to be organizing productive activities in order to maximize *wellbeing* in society. As MacLeod acknowledges,

> "today, the typical business corporation seems to be a disjointed entity whereby shareholders seek maximum returns, labor unions seek maximum income, and managers vie for maximum salaries and bonuses. The needs of society in general seem to be ignored in this dynamic. Indeed, the formula appears to point in a direction that can only lead to trouble for those outside the three competing elements of the modern business corporation; the recent economic meltdown would appear to confirm the deep faults in the current concept of the business corporation."[247]

Discussions on the social value of business activity turn a spotlight on the intricate relationship between *wealth* and *welfare*. Economics is the study of human behavior and its manifestations on the productive system so that social wellbeing could be maximized by means of wealth generation –not vice versa. Economic actors who are emotionally vested in their localities, and own businesses whose mission to further social progress in those areas would be more inclined to get pleasure from their work and life, and work more productively. Serna notes that "although incentives are important, socializing individuals so they feel like an insider may play a vitally important role in determining the failure or success of organizations and, potentially society in general."[248] As Francis A. Walker's observation in 1886 suggests, economics' neglect of worker psychology has deep roots: "Economists tend to be in bad odor amongst real people, because they often ignored the customs and beliefs that tie individuals to their occupations and locations, and lead them to act in ways contrary to the predictions of economic theory."[249]

The way Mondragón Cooperative weathered the global recession in 2009 exemplifies the social welfare benefits attached to the heightened sense of social

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[247] Greg MacLeod, "The Mondragon Experiment," *Harvard International Review*, April 4, 2009.
[248] Gabriel R. Serna, review of *Identity Economics: How Our Identities Shape Our Work, Wages, and Well-Being*, by George A. Akerlof and Rachel E. Kranton, *Journal of Economics Issues*, March 2012, Book Reviews.
[249] Ibid.

responsibility in cooperative businesses. One of the world's most successful companies, the Basque-based Mondragón is an industrial conglomerate of 250 businesses, 120 of which are cooperatives. The company makes 20 billion dollars a year from its operations in 16 countries, and employs a work force of 85,000 people half of whom are co-op members. When the Great Recession hit the global economy in 2008, Mondragón responded in a unique way possible only in a collaborative cultural context endorsed in cooperatives. Instead of laying off workers or downsizing operations as most commercial companies would do, Mondragón's leadership implemented a system of rotational unemployment. 20% of the labor force was selected in a random drawing, and put on unemployment status for the duration of eight months. During this period, these workers were compensated with 80% of their regular income, and received training to expand their job skills in the companies' cooperative university and other training facilities. After eight months, another drawing was carried out on the remaining 80% of the workers, and the new group went on rotational unemployment status while the first group was placed in jobs in Mondragón companies within 30 miles from their old jobs. The system turned out to be successful, and the company eventually regained its profitability without any worker losing his/her job along the way. Mathews attributes this outcome to a heightened sense of loyalty among owner-workers who are "prepared to make significant sacrifices where necessary in order for their co-operatives to remain in business".[250]

Hansmann's observation that the leading cause of failure for co-ops is the dilution of the cooperative spirit is a testimony to the crucial role communal feelings play in cooperatives' performance.[251] Cognizant of this potential challenge, Mondragón's credit union Caja Laboral recommends establishment of a new co-op when a co-op reaches 500 members so that "[…] workers have a true sense of ownership of the enterprises in which they are employed." Ballantyne notes that "this is quite a

[250] Robert H. Frank, *The Economic Naturalist's Field Guide: Common Sense Principles for Troubled Times* (New York: Basic, 2009), 1.
[251] *The Economist*, "All in this together," March 26, 2009.

contrast from the relentless process, seen in the rest of the corporate world, of economic mergers, acquisitions and takeovers."[252] Essentialness of cooperative spirit in co-ops' success was confirmed in Zimbabwe where the failure of producer cooperatives in the 1990s was largely explained by the "prevalence of an organizational culture that enabled leading members to seek individual self-interest and private gain, [which made …] it hard for the rank and file to cooperate and work for the common good."[253]

The case of United Airlines is a thought-provoking support for the role of cooperative spirit in endorsing socially desirable outcomes. In 1994, the Chicago-based company sold 55% of its stocks to its employees in exchange for lower compensation at a time of cash flow challenge. While the move was welcomed as a contribution to workplace democracy and employee loyalty,[254] it did not boost cooperative spirit in the company as it was not supported by a training program that raised collective consciousness in the corporation. Consequently, clashes occurred between employee-owners that belonged to different unions, and brought the company on the brink of bankruptcy in a matter of a few years. The company had to merge with Continental Airlines in 2010 in order to sustain its viability. The move further diluted worker control and increased union competition, and in late 2012, United/Continental company registered a low prompt arrival rate of 77.5% -six points below the industry average, more customer complaints to the Transportation Department than all other carriers combined, and a $103 million loss at a time when its competitors were profitable.[255] United Airlines experience marks a stark contrast to the experiences observed in cooperatives in which union membership is not common due to owners and workers not existing as separate classes with competing interests.

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[252] Ibid.
[253] Kofi Akwabi-Ameyaw, "Producer Cooperative Resettlement Projects in Zimbabwe: Lessons from a Failed Agricultural Development Strategy," *World Development* 25, no. 3 (1997): 437.
[254] Jeffrey N. Gordon, "Employee Stock Ownership in Economic Transitions: The Case of United Airlines," *Journal of Applied Corporate Finance* 10 (1998): 39.
[255] Jad Mouawad, "For United, Big Problems at Biggest Airline," *New York Times*, November 28, 2012.

The sense of social responsibility built in cooperative values benefits members of co-ops on a daily level in non-crisis times, as well. A 2012 study by the National Cooperative Grocers' Association found that 82% of the produce in an average co-op grocery store are organic while only 12% are as such in conventional stores.[256] These products constitute 2% of total sales in corporate stores, but 82% in cooperative stores. An average co-op store pays 7% higher wages, qualifies 21% more of its employees for health care, and spends 46% more of its revenues for its local community. It also recycles 74% of its food waste (vs. 36% in non-coop stores) and 81% of its plastics waste (vs. 29%), and secures an energy star score of 82/100 (vs. 50/100 in conventional stores). National Credit Union Administration reports support the notion that cooperative type businesses act more socially responsibly than investor-owned corporations in the financial sector.[257] While mortgage approval rates for moderate and low income families are 52% in commercial banks, it is 67% in a typical credit union, which constitutes 25% of all mortgages provided. More than a third of banks refuse credits to non-white applicants while the same figure is less than a fifth for credit unions. Between December of 2007 and September of 2011, real estate loans and business loans dropped by 15% and 3%, respectively in commercial banks while rose by 14% and 42%, respectively in credit unions. These figures contributed to a 7% decline in banks and 7% increase in credit unions in total loans.

1.4.1.5 Concept of *Sustainability*

Another feature that sets cooperatives apart from commercial corporations is the *long-term outlook* that guides managerial perspectives in cooperatives. Sustainability is a primary and descriptive concern in cooperative governance. As co-ops are established

[256] National Cooperative Grocers'Association (NCGA). *Healthy Foods, Healthy Communities: Measuring the Social and Economic Impact of Food Co-ops*. Iowa City, IA: NCGA, 2012. http://strongertogether.coop/wp-content/uploads/2013/07/Healthy_Foods_Healthy_Communities.pdf (accessed February 25, 2013).

[257] Anonymous, "Just the Facts: What's So Good About Co-ops?" *Yes*, February 20, 2013.

with the initial capital of their founding members who do not expect to maximize their monetary returns, furthering social wellbeing sustainably remains to be an existential purpose in cooperatives. Cooperative business model consists of various mechanisms to ensure that new members who join co-ops later on would not compromise long-term outlook inside co-ops. For example, Mondragón offers life-long employment to its members, and guarantees that if a Mondragón co-op is closed, it would place its members to another constituent co-op within 30 miles from the closed one. It also requires 13,400 Euros to become a member, which encourages members to commit to their co-op with a longer-term outlook.[258] Membership fees allow the co-op to raise capital for its operations, and funds the company's credit union Caja Laboral in its mission to provide favorable loans to members. Moreover, some cooperatives pay their members fluctuating advances from their projected earnings instead of a fixed salary, which is another feature that supports the culture of long-termism and self-discipline. Because employees are positioned as productive elements rather than expense items, their self-driven motivation to earn living by contributing to a common cause proves to be a stronger motivational tool than exogenous pressures from supervision or the threats of a layoff. Long-term outlook translates into longevity for cooperatives –as evident in England where a twentieth of new co-ops, but nearly every other businesses fail.[259]

Different ways cooperatives and corporations behave organizationally begins in their nascency. Initial source of financing for corporations are typically personal investments of the founders or venture capital they borrow. This leaves the founders with a debt stock that needs to be paid off as rapidly as possible. As time works against the interests of the borrowers with an increasing burden of interest, company's administrators do everything in their power to maximize their profitability in order to deleverage their business. Compounded by further borrowing in later phases of the business, this motivation sets profit maximization as an essential and permanent feature

[258] Randeep Ramesh, "Basque country's thriving big society," *The Guardian*, March 30, 2011.
[259] Emily Barker, "Co-ops provide a lifeline for communities: Growing the co-op economy," *Cooperative News*, November 7, 2012.

of the corporate culture. On the other hand, cooperatives are financed through their members' equity on their onset. Their initial membership fees are supplemented by retained surplus from the co-op's operation every year. Furthermore, corporate laws in the U.S. provide different incentives that produce different outcomes to co-ops vs. corporations.[260] Modigliani-Miller Theorem argues that tax laws in the U.S. encourage investor-owned corporations to raise capital by selling debt instruments. While corporate indebtedness rises over time, laws provide incentives for co-ops to avoid debt financing. Cooperatives are allowed to pass through their retained surplus to their members tax-freely, which leaves co-ops to use borrowing solely for investment purposes as it is originally intended to be. As borrowing from financial markets does not constitute a primary way of financing, co-ops are not motivated by profit maximization in their business dealings. Even when co-ops opt in leveraging to fund their investments, they often bank with credit unions, which are cooperative banks whose same cooperative commitments allow them to provide sensibly favorable loans for their members.

1.4.1.6 Concept of *Economic Democracy*

Finally, cooperatives harbor a commitment to *economic democracy* in their reason for existence. As a movement that started in response to exploitation of workers in commercial companies during the Industrial Revolution, cooperativism is based on the idea of democracy at work as a means to provide an equitable and fair economic sphere. Foundational principles of *Rochdale Pioneers* –the world's first consumer cooperative established in 1844 in Rochdale, England- have inspired universal values of cooperativism. These values, which distinguish cooperatives from other forms of organizations, are

. voluntary and open membership,

. democratic member control,

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[260] Shermain D. Hardesty and Vikas D. Salgia, *Comparative Financial Performance of Agricultural Cooperatives and Investor-owned Firms* (Davis, CA: UC Davis Rural Cooperatives Center, 2004), 2.

. member economic participation,

. autonomy and independence,

. education, training and information,

. cooperation among cooperatives, and

. concern for community.[261]

Voluntary and open membership refers to cooperatives' obligation to accept any interested person as a member regardless of his race, ethnicity, gender, or political or religious conviction. Cooperatives have to be open to everyone who is willing to satisfy membership requirements, and members have to be given the liberty to leave the co-op on their free will. Co-ops embrace *democratic governance*, and give equal voting rights to all members. In co-ops, every member has one vote regardless of the size of his/her contribution to the co-op. This feature contrasts with investor-owned corporations that give voting rights in proportion to the number of shares held. As José Maria Arizmendiarrieta who started Mondragón in 1956 once said, "knowledge must be socialized so that power can be democratized."[262] Carey adds that

> "democratic capitalism combines the free market energies of competition and private property with the enormous productivity and innovation released in an environment of trust and cooperation. […] The persistent human failure to employ reason in order to associate in trust and cooperation at the global level has resulted in a terrible performance: continued misery for many and violence or fear of violence for all. […] This condition is unnecessary and […] citizens can eliminate material scarcity, elevate spirits, unify people, and stop the violence by moving company practice and public governance to democratic capitalism."[263]

Cooperatives employ a number of practices to ensure the *autonomy* of individual members against other members, and of the members as a congregation against external forces. To serve the former purpose, co-ops seek homogeneity in contributions so that no

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[261] Anonymous, "Living the Seven Cooperative Principles," *Credit Union Management* 35/11 (2012): 50.
[262] "The Mondragon Project," accessed February 28, 2013, http://praxispeace.org/pdf/Mondragon-2012-Brochure.pdf.
[263] "Ray Carey - Air date: 15-07," YouTube video, 58:14, posted by "Harold Channer," July 15, 2011, http://www.youtube.com/watch?feature=player_embedded&v=uaY5WuYwkg8

single member would support the co-op significantly more than others, and accordingly, have disproportionate influence on management. For the latter goal, cooperatives avoid arrangements that would grant voting rights to non-member entities. For instance, most cooperative bylaws disallow their managements to take out loans that give administrative rights to lending institutions.

Continuous education is a crucial social democratic function in cooperatives due to the fact that cooperatives' achievements rely heavily on the sustainment of their members' commitment to cooperative ideals. Co-ops dedicate a part of their resources (typically around 10% of the annual surplus) to educational programs that allow them to further the cooperative spirit among their members, and to improve members' professional skills for higher productivity. Additionally, most co-ops regularly spend a portion of their surplus to community projects like scholarship funds, sponsorships of social events, or educational programs.

Cooperativism further supports economic democracy with the idea of equitable income distribution it endorses. Various criticisms of capitalism commonly acknowledge heterogeneous distribution of income and wealth as a problematic outcome of capitalist economies. In capitalism, business proceeds disproportionately accumulate on the side of capitalists as a value attribution to their contributions to the productive process (entrepreneurship, risk-taking, administrative skills, networking ability, knowhow, opportunism): "The ethical principle that would directly justify the distribution of income in a free market society is," as Friedman once wrote, "to each according to what he and the instruments he owns produce."[264] Cooperativism rejects this argumentation, and considers the commercial business model in which owners and workers exist as two classes with competing interests undemocratic. Material subjugation of workers who actually labor the production is undemocratic both economically and politically.

[264] Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 161-2.

Heterogeneous distribution of wealth translates into disproportionate representation in political stage as it "[…] increases the relative power of the wealthy to shape politics in their own favor, [… and] powerfully depress political interest, the frequency of political discussion, and participation in elections among all but the most affluent citizens […]. Greater economic inequality yields greater political inequality."[265] When moneyed interests dominate the administrative, legislative and regulatory functions of the government; politically-earned market positions, regressive tax privileges and corporate overwhelming of the democratic rights of the labor characterize the political economy. Subsequently, inequality of income and wealth grows rendering productive capacity of the economy inefficiently underutilized, economic instability persistant, and the principles and identity of the US society compromised.[266] Such a commercialized political system that breeds generations of elected leaders who feel pressed to respond to the demands of the ruling class in order to sustain their political power and secure rewarding post-government careers spells the transformation of politics from a form of public service into a means to self-service.

Cooperatives that redistribute their surplus to members according to their contributions/patronage address the problem of income disparity in a fundamental way. As community-oriented businesses owned by local people as workers, consumers, producers or entrepreneurs, co-ops spend more of their income locally, which is an economic condition that accelerates local economic growth. A study on cooperatives in Finland concludes that "one aspect especially worthy of noticing is the fact that the surplus of cooperatives' economic activity remains (mostly) within their operating

[265] Frederick Solt, "Economic Inequality and Democratic Political Engagement," *American Journal of Political Science* 52, no. 1 (2008): 48.
[266] Joseph Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (New York: W. W. Norton & Company, 2012), xxxvii–lviii.

area."[267] In the United States, co-op grocery stores leave 38% of their income in their local economy whereas investor-owned supermarkets spend 24% of their income locally.[268] 20% of co-op stores' products are locally supplied (vs. 6% in other stores), and co-ops devote 13% of their income to charitable donations (vs. 4% in their corporate competitors). On average, 157 local businesses do business with a co-op whereas the same figure is 67 in conventional stores. In any given economy, larger the proportion of business proceeds that stay in the economy with respect to the amount that flees, more likely the economy is to grow. Due to *Keynesian multiplier effect*, every dollar that stays locally stimulates effective demand that is several times of it in the same area.[269] Accordingly, co-op stores that keep a larger share of their income locally expands the local economy's productive capacity more than conventional stores do. A study by National Cooperative Grocers' Association found that cooperative grocery stores pay 7% higher wages than their commercial competitors, and they have an higher economic impact multiplier (1.60 vs. 1.36) than conventional stores.[270]

Cooperatives are instrumental in improving efficiency without increasing environmental degradation in an economy. Agricultural machinery co-ops illustrate this aspect. In agricultural field, machinery is an invaluable resource to improve efficiency. A common challenge, however, is that most technological machines are too expensive to justify their purchase for a single farmer. The solution for farmers, then, is to establish a cooperative, pool their capital to purchase expensive machines, and use them on a rotating basis. Cooperative allows them to lower their production costs, increase their productivity, and prevent waste that would have occurred in the case of each farmer owning his own machinery and keeping them idle most of the year. Because co-op

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[267] Iiro Jussila, Ulla Kotonen and Pasi Tuominen, "Customer-owned Firms and the Concept of Regional Responsibility: Qualitative Evidence from Finnish Co-operatives," *Social Responsibility Journal* 3, no. 3 (2007): 41.
[268] NCGA, p. 9.
[269] Bülent Temel, "Çağdaş Bir Kalkınma Modeli: Küreselleşerek Yerelleşme," [A Contemporary Development Model: Localization by Globalization] *Cumhuriyet*, September 28, 2012.
[270] NCGA, p. 10.

members own the capital in their co-op, they also take better care of the physical capital in their value-addition process, which reduces the need for supervision and the costs attached to it.[271]

Cooperatives have conventionally been proven to be instrumental in rural development. Their locally-owned, non-profit seeking structure allows local communities to carry out infrastructure projects that are unfeasible for profit-maximizing corporations to invest in. Allocation of rural resources to cooperative development is not a choice with a high opportunity cost, either. Logue and Yates found in a 2005 study that cooperatives' productivity does not trail behind corporate productivity in a statistically significant way.[272] An earlier survey of the cooperative literature further concluded that "no credible evidence exists to support the proposition that cooperatives are inefficient relative to investor-owned businesses."[273] Producer cooperatives often demonstrate that profitability and social consciousness do not constitute a trade off. Tire Süt Kooperatifi (Tire Milk Cooperative) in Western Turkey is a case in point. The cooperative, which has grown to produce 150 tons of milk every day from local farmers, and consistently sponsors social projects like the free milk program implemented in local public schools, was named the *Best Rural Development Model* by the United Nations.[274]

In order to fully comprehend cooperatives' contribution to democratic wellbeing in a society, one ought to evaluate them on the basis of an aggregate measure such as *community wealth*, which considers intellectual, social, individual, natural and political

[271] John Pencavel, "Worker Cooperatives and Democratic Governance," in *the Handbook of Economic Organizatiom: Integrating Economic and Organization Theory*, ed. Anna Grandori (Cheltenham, UK: Edward Elgar Publishing, 2013), c. 24.
[272] John Logue and Jacquelyn Yates, "Productivity in cooperatives and worker-owned enterprises: Ownership and participation make a difference," *World Employment Report 2004-2005* (2005): vii.
[273] Richard J. Sexton and Julie Iskow, "What do we know about the economic efficiency of cooperatives: An evaluative study," *Journal of Agricultural Cooperation* 8 (1993): 24.
[274] Sabancı Vakfı, "Tire Milk Cooperative Makes a Difference in the Lives of People in Tire," http://www.sabancivakfi.org/page/tire-milk-cooperative.

capital in addition to financial capital.[275] Introduced in 1998 by a group of French cooperativists, *bilan sociétal* (social balance sheet) has become a program that lays out a set of standards for cooperatives to assess and improve their performance in social matters like democracy, human progress and environmental sensitivity.[276] It is a 450-question questionnaire with which businesses evaluate their performance in productivity, social effectiveness and environmental impact. It also endorses communication between external as well as internal stakeholders, transparency, sustainability of reforms, and dissemination of functional and responsible practices amongst cooperatives.

Cooperativism invites a discussion of the relationship between *growth* and *development*. While these two concepts are closely related to each other and are often used interchangeably in the literature, there are substantial differences between them, and these differences are more instructive for economic thought than their commonalities are. *Growth* marks the rate of increase in output in an economy whereas *development* refers to institutionalization of factors that facilitate quality of life. Because development requires financial means, which derive from economic production; development can be realized only upon the growth of the economy –though *growth* makes a poor proxy for *development*. Presence of a functional legal system, for instance, is an element of development, but it is not represented by the traditional indicators of growth (GDP, GNP, GNI, etc.).

Similarly, *per capita income,* which is used by the neoclassical mainstream in classifying countries as *developed*, *developing* or *underdeveloped*, is a misleading indicator of development in countries. Arithmetic average of national output informs minimally about the distribution of income in the country (which points to the life

[275] Doug Hoffer and Melissa Levy, "Measuring Community Wealth," A report for the Wealth Creation in Rural Communities project of Ford Foundation (2010): 5-6.
[276] De Gobbi, Maria S. "Mainstreaming environmental issues in sustainable enterprises: An exploration of issues, experiences and options," International Labor Organization Working Paper No. 75, 2011. http://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_150630.pdf, (accessed February 2013).

standard attached to the concept of development), and presents consumption as an element of progress without making distinction between different forms of consumption. For example, cutting trees in an area increases the GDP, which makes the level of development or prosperity in the local economy appear to have increased, while it actually lowers the quality of life for people in the area. In this respect, cooperatives that carry out economic activities to further wellbeing of their communities differ from for-profit corporations that use the society to further monetary interests of their owners. "Rational and holistic analyses and implementation of cooperatism would support producers, consumers, small businesses and other stakeholders, mobilization of idle capacity, expansion of microcredit and financial opportunities, accumulation of capital, creation of employment, growth in production, integration of smaller businesses with larger industries, constructive regulation of markets, improvement of the culture of entrepreneurship and team work, widening of social capital, fairer sharing of income, reduction of poverty, and accordingly development of a country as a whole."[277]

1.4.2 Limitations of the Cooperative Model

The capability of cooperativism as a socioeconomic movement to endorse economic stability and equity, and social development is compromised by a number of restrictions. A leading one of these restrictive challenges is the competitiveness issue posed by *globalization*. In economies where foreign trade controls are minimized, large multinational corporations pose an insurmountable threat to local economic actors in their struggle for survival. Large corporations with a large supply volume and networks to outsource in low-cost factor markets use their scale economy advantages to drive their domestic competitors away from the markets they penetrate. Smaller, locally-endowed organizations such as cooperatives lose their price-competitiveness against such large corporations, and their markets shrink to smaller consumer markets that is motivated by

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[277] "T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], Kooperatifçilik Genel Müdürlüğü [General Directorate of Cooperativism], Türkiye Kooperatifçilik Stratejisi ve Eylem Planı [Turkish Cooperativism Strategy and Action Plan] (Ankara, 2012), 1.

non-price concerns such as environmental concerns due to long transportation of goods and services by large corporations, unemployment caused by large multinationals that produce abroad, or income disparity associated with the commercial multinational corporate form with many shareholders scattered around the world.[278]

Another challenge that creates a gap between cooperatives' potential and actual growth rates around the world is the increasing ideological hegemony of *liberal individualism*. As Borgen notes in his historical account of agricultural cooperativism in Norway; cooperatives appeared compatible with the "collectively oriented cultural heritage" of Norway until the early 1990s, but began to lose their relevance since then as a result of a shift in common priorities.[279] Based on "libertarian ideas," European Economic Community's increased attention to "competitiveness and individual freedom [… came] to the expense of egalitarianism and solidarity."[280] As trade restrictions were reduced to accommodate the efficiency priority, and regulatory emphasis shifted to stimulating innovation and entrepreneurship, cooperatives' capability to create competitive strategies for themselves were compromised on an increasing scale, and the agency theory has become increasingly useful in understanding cooperatives' challenges.

These challenges build on the issues cooperatives have conventionally faced due to their peculiar organizational design. As organizations that were created as a response to exploitation and misdistribution of power in investor-owned businesses, cooperatives rely on the idea of economic democracy (one-person one-vote principle rather than the one-share one-vote mechanism in capital-oriented businesses). They also offer limited

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278 Kimberly A. Zeuli and Robert Cropp, *Cooperatives: Principles and Practices for the 21st Century* (Madison, WI: University of Wisconsin, 2004), 78.
279 Borgen, Svein Ole. "Agency Problems in Norwegian Agricultural Cooperatives" NILF Working Paper No. 2002-3, 2002.
http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.201.7351&rep=rep1&type=pdf, (accessed March 04, 2015).
280 Ibid.

returns on invested capital in order to disallow membership for personal gains rather than common interests. While these two principles help cooperatives operate with a long-term outlook, social purpose and equitable distribution of power and proceeds; they also create a negative externality. Indivisibility and non-salability of owners' equity in cooperatives with common property can lead to a *free rider problem*. Founding members of cooperatives who earn limited returns from their founding capital, and cannot trade their interests notice that later members (and to a lesser extent, non-members) who do not contribute with the same high level of up-front capital would receive most of the benefits of cooperatives found members enjoy. Similarly, free riding can also occur externally when those who are not members to a cooperative take advantage of some benefits associated with co-op membership (an example would be a non-member farmer gaining the power to demand a higher price for his produce thanks to remaining as the sole supplier other than a co-op which successfully organized other farmers and negotiated with retailers for higher prices). Consequently, founding members' motivations, which are essential for cooperatives to remain sustainable, diminish – providing a common barrier in front of cooperatives' growth.[281]

Challenges in trading owners' equity as dividable commodities increase opportunity costs of cooperatives.[282] Difficulty in trading ownership shares drives cooperative members to adopt a myopic outlook on long-term investing. As a result, cooperatives typically invest their capital in short-term instruments, which due to their shorter time span, are predictably less volatile and productive. This *portfolio problem* spells losses in terms of unearned returns on investments, and accompanies horizon problem as a hindrance to growth.

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[281] Michael Cook, "The Future of U.S. Agricultural Co-operatives: A Neo-institutional Approach," *American Journal of Agricultural Economics* 77 (1995): 1153–9.

[282] The word "challenge" is used here instead of "inability/impossibility" due to the fact that some types of cooperatives such as housing co-ops do offer tradable shares of ownership under certain conditions.

Horizon problem refers to cooperatives' tendency to resort to equity redemptions at the expense of funding long-term capital investments due to members' preference. Because cooperative members earn returns on their capital in proportion to their patronage to the co-op, they tend to prefer patronage returns in the present time when they are contributing to the co-op rather than a future time when they may not offer the same level of patronage. As a result, cooperative managements –acting upon the preferences of their member body- opt in the distribution of surplus to members rather than retaining them for future growth. Under-investment to opportunities that promise later payoffs slows down cooperatives' growth prospects.[283]

Ortmann and King argue that the one-vote-per-person principle can also associate with inefficient management in cooperatives on their path to growth.[284] When a small cooperative succeeds and grows, it needs and attracts more people as members and managers. As the member body and co-op operations expand, member interests inside the co-op diversify while the need for non-member professional managers increases. Managers who are not members to the co-op or those who become a member due to their newly assumed managerial position rather than prior interests find it increasingly difficult to accommodate the expectations of their member body that indirectly hires them. Absence of a mechanism that guides managers in prioritizing interests creates space for influence peddling inside co-ops. Member groups would organize to influence the management for taking decisions that favor their narrow interests –creating an *influence cost problem* in terms of direct waste of resources used for influence as well as misallocation of resources as an indirect outcome of influence peddling. Consequently, cooperative managements may opt out of growth opportunities for the sake of responding to the diverse set of expectations of the member-only boards

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[283] Ibid.

[284] Gerald F. Ortmann and Robert P. King, "Agricultural Cooperatives I: History, Theory and Problems," *Agrekon* 46/1 (2007): 48-9.

and the non-managerial members. This *governance/control problem* can be exacerbated further if those members who are less interested and knowledgeable about the co-op participate in voting in large numbers –influencing the outcome of voting towards ends that may not necessarily serve the best interests of the co-op. Occurrence of this outcome can discourage other members who are actively involved in their co-ops' and are better equipped to make informed decisions from participating in voting.

While cooperative challenges are real and imminent, they do not necessarily compromise the future expansion and accomplishments of the cooperative movement around the world. Internal free rider problems that emerge due to heterogeneous distribution of capital contribution requirements between founding and non-founding members can be mitigated by innovative administrative policies. As exemplified by Mondragón Cooperative in Northern Spain, which requires €13,400 from new members to join in,[285] cooperatives can close the contribution gap between earlier and later members. Other forms of in-house free riding can be eliminated by means of labor management technologies such as computer records that document each member's exact contribution to the co-op, or magnetic ID cards that track work hours. External free riding possibilities, which stem from unavoidable spillovers, may continue to exist, however cooperatives are vulnerable to it no more than commercial businesses are. This condition is similarly present for the horizon problem as shareholders in investor-owned businesses have been consistently found to have a short-term outlook on investment returns.[286]

Influence costs are likely to exist in cooperatives with large member congregations; however, these costs are mere eliminations of a cooperative advantage over commercial competitors. They eliminate cooperatives' feature as endorsers of

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[285] Ambrose Evans-Pritchard, "Spain's astonishing co-op takes on the world," *The Telegraph,* sec. Finance, February 16, 2011.
[286] Emeka Duruigbo, "Tackling Shareholder Short-termism and Managerial Myopia," *Kentucky Law Journal* 100 (2012): 531-84.

economic democracy, and bring them to the same footing as investor-owned businesses, in which voting power is distributed heterogeneously by design. Lack of electoral participation as a result of discontent among the voting members provides no particular disadvantage to cooperatives in competition to commercial businesses where voters with highest stakes in the business typically dominate shareholder meetings.[287]

Nonetheless, we find ideological concerns to be a daunting issue that is likely to challenge the global expansion of cooperativism in the near future. In an age whose common spirit is describable with words such as nihilism, self-centeredness, egoism and short-termism as much as independence, innovation and efficiency;[288] it is increasingly difficult for people to have a mindset that would allow them to favor levelheaded and collectivist initiatives such as cooperativism. Neoliberalism, with its profound ability to transform the hearts and minds with its clever association with *free*dom, has proven to be more than an economic doctrine with purely economic consequences. Its dismissal of the most powerful institution that could pursue normative purposes in the society -government- leaves societies vulnerable at the domain of commercial businesses. Pressured between social expectations that define success largely in monetary terms, and a sense of distrust to fellow citizens in a society infested by a radical version of individualism; ordinary people find the idea of establishing or supporting a not-for-profit that looks after social as well as personal interests abundantly unattractive. Subsequently, cooperativism cannot appeal to larger segments of the general public, which goes beyond the lower-socioeconomic segment that is driven to cooperatives out of necessity (farmers who need marketers for their produce and providers of expensive machinery, low-income households that can only get favorable loans from credit unions, rural people who have to rely on each other in bringing utilities to their areas unserved by the government, etc.). Cultural incompatibilities exacerbated by ideological

[287] Abe de Jong, Gerard Mertens and Peter Roosenboom, "Shareholders' Voting at General Meetings: Evidence from the Netherlands," *Journal of Management & Governance* 10/4 (2006): 353-380.
[288] Charles Derber, *The Wilding of America: How Greed and Violence is Eroding Our Nation's Character* (New York: St. Martin's Press, 1996), 155.

indoctrination in the age of neoliberalism reflect on the attitudes of policymakers, lawmakers and business schools towards cooperativism –posing the most imminent and formidable threat to the future of cooperativism around the world.

Next two essays provide an assessment of cooperativism as an instrument of stability (Chapter 2), and contextual restrictions that determine its instrumentality (Chapter 3). First analysis focuses on cooperative banks (credit unions) and commercial banks in Canada in order to unveil the differences between managerial risk appetites in these two sets of organizations. Econometric estimations consider a number of factors that are potentially influential on risk tolerance in the sector, and examine the robustness of the proposition that commercial and cooperative financial institutions are governed by different levels of risk tolerance attributable to their teleological differences. In the second analysis of the relationship between cooperative form and contexts, Chapter 3 examines the extent to which contextual realities influence cooperatives' performance around the world.

CHAPTER 2

COOPERATIVE RATIONALE IN BANKING: EVIDENCE FROM NORTH AMERICAN FINANCE

This chapter examines the extent to which cooperative rationale can associate with organizational stability in the particular of financial sector in Canada. Financial sector makes a suitable analytical unit for this analysis as it is a special sector that functions as a bloodline for economies. Its failure in channeling savings to productive means in an efficient manner creates adverse effects on the larger economic activity – leading to a range of problems from minor contractions in output to major recessions. From this motivation, this chapter looks in the financial sector in Canada in order to get a sense of whether financial institutions that are organized as cooperatives (*credit unions*) are governed with an heightened sense of risk wariness than their competitors established as commercial businesses. Independent from the previous and the next chapter, with which it collectively examines the dissertation's main inquiry, this analysis furthers the literature on financial sector stability with its application of cooperative theory onto the studies of organizational stability in financial sector in North America.

2.1 Cooperatives in Finance: Credit Unions

Credit unions are "[…] member-owned, not-for-profit financial cooperatives that provide savings, credit and other financial services to their members."[289] As public purpose enterprises in social economy, each credit union describes its "community" in its own bylaws, which determines conditions for membership eligibility. In most credit unions, membership consists of main stakeholders –depositors, borrowers and employees. Administrative duties are handled by board of directors who are member

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[289] "What is a Credit Union?" World Council of Credit Unions, accessed July 17, 2014, http://www.woccu.org/about/creditunion.

volunteers elected by the members. In annual meetings where voting takes place, every member has only one vote regardless of the size of his/her deposits or loan balance, or seniority in service to the credit union. Service to community describes credit unions' existential purpose, and member body monitors the organization's governance to make sure directors observe this purpose. Even though it is not a requirement to be classified as a credit union, most credit unions are local organizations with a local congregation and focus. Requirements such as official residency in a particular zip code, or arrangements with certain municipalities for sponsorship of public functions contribute to their local identity.

Congruent with universal cooperative principles, credit unions value democracy and independence. They embrace transparency in corporate governance in recognition of members' democratic rights to be informed, and they refrain from involvements in political campaigns in order to maintain their autonomy against external influences that can compromise their cooperative ideals. Regulated at regional level, at least one insurance agency protects deposits in credit unions in each region –often in amounts that are larger than those provided for commercial banks.

2.2 History of Credit Unions

As a distinct form of financial institution, first credit unions were created in the mid-19th Century Europe as a response to the marginalization of the working class by the financial system during the Industrial Revolution.[290] German economist Franz H. Schulze-Delitzsch was mobilized by dire conditions of workers when he became the head of a commission to investigate the wellbeing of artisans and laborers. He started the world's first credit union in his native town of Delitzsch under the name *Vorschussvereine* (People's Bank). Based on the idea of working people meeting each

[290] Ian MacPherson, *Hands Around the Globe: A History of the International Credit Union Movement and the Role and Development of the World Council of Credit Unions* (Victoria, British Columbia: Horsdal & Schubart Publishers, 1999).

other's financing needs with their own capital, the bank grew rapidly into 200 branches within nine years, and attracted other entrepreneurs to benchmark the same model around Europe. Local politician Friedrich W. Raiffeisen applied the credit union model to rural areas in Germany where farmers with unstable and low income were often victims to usury –setting the first few examples of agricultural credit unions in the world.

The concept of cooperative banking spread to North America in the 20th Century. First credit union in the region was established in Levis, Quebec (Canada) in 1900 by publisher and journalist Gabriel-Alphonse Desjardins. The organization targeted low income people who had been excluded from commercial banking services, and became successful in providing reasonable interest rates to its depositors and borrowers. Eight years later, a group of Canadian immigrants opened the first credit union in the United States. St. Mary's Bank was founded in Manchester, NH under the leadership of church administrator Pierre Hevey and attorney Joseph Boivin. Credit unions in the U.S. have grown rapidly partly due to the success of *association bonds* –an innovative lending instrument they invented.[291]

In 1934, credit unions in the United States were organized around a new association called CUNA (Credit Union National Association). Between 1950 and 1970, CUNA's collaboration with its Canadian, European and Australian counterparts and various developing country governments led to the spread of credit unions around the world to finance development in these areas. The U.S. Government's Foreign Assistance Act of 1961 established USAID (U.S. Agency for International Development), which provided capital for the establishment of credit unions around the world to facilitate

[291] Also known as *common bonds*, these bonds were social debt obligations that allowed lending credit unions to use future paychecks as collateral in loans issued to low-income borrowers whose financial prudence was provided by monitoring from the community. Common bonds were an early precedent to the concept of *microfinance*, which used social shame as collateral –earning its inventor Muhammad Yunus a Nobel Prize in Economics in 2006.

socioeconomic development. In 1970, associations of credit unions around the world were united under the World Council of Credit Unions established in Madison, WI to support the credit union movement globally. Today, credit unions play essential roles as sponsors of development programs in developing countries, and as not-for-profit competition for commercial banks in developed countries. Two largest credit unions in the world, Navy Credit Union (U.S.A.) and Desjardins Group (Canada), serve nearly 11 million members and control $247 billion in assets combined. In the United States alone, there are 100 million credit union members,[292] and in Canada, a third of the population is a member of at least one credit union.[293]

2.3 A Discussion of Credit Unions' Achievements

Achievements of the cooperative banking sector have become visible during the course of the Great Recession. Whilst some of the oldest, largest and most reputable commercial banks that controlled a vast portion of assets in U.S. banking (Citigroup, Washington Mutual and Wachovia Bank among others) had to be acquired due to insolvency, credit unions have increased their assets, outstanding loans, customer counts and profits while decreasing their loan defaults, and not a single credit union filed for bankruptcy or applied for recapitalization anywhere in the world during the global recession. In 2008, outstanding loans dropped by $31 billion in commercial banks, but increased by $36 billion in credit unions in the United States.[294] Between 2008 and

[292] Jonnelle Marte, "About 100 million Americans are now using credit unions. Should you join them?" The Washington Post, August 5, 2014, accessed September 23, 2014, http://www.washingtonpost.com/blogs/wonkblog/wp/2014/08/05/about-100-million-americans-are-now-using-credit-unions-should-you-join-them/.

[293] "Facts and Figures," Credit Union Central of Canada, accessed July 19, 2014, http://www.cucentral.ca/SitePages/Publications/FactsAndFigures.aspx.

[294] Jonnelle Marte, "Safe Havens: Credit Unions Earn Some Interest," *Wall Street Journal,* sec. Personal Finance, March 15, 2009 cited in The World Council of Credit Unions, Cooperative Banks, Credit Unions and the Financial Crisis. Available at www.un.org/esa/socdev/egms/docs/2009/cooperatives/Crear.pdf, accessed July 21, 2013.

2010, community development credit union[295] assets, net worth, loan portfolios and membership count have grown by 19.7%, 16.7%, 7.2% and 7.9%, respectively.[296] A study in 2010 concluded that one percentage point increase in unemployment rate was associated with 25% less charge-off growth in credit unions than in banks, which indicates less sensitivity to macroeconomic shocks among credit unions.[297] One of the most celebrated capitalists in modern time, Jack Welch, the fabled CEO of General Electric from 1981-2001, landed an unlikely support for cooperative banking model in 2009 when he publicly uttered that targeting value maximization was "the dumbest idea in the world," and suggested "everybody [to] pile into co-ops instead."[298]

Proponents of commercial banking argue that credit unions' accomplishments are attributable to tax privileges granted to them by the government. As financial institutions that are "organized and operated for mutual purposes and without profit,"[299] credit unions are exempt from corporate taxation in the United States. Federally chartered credit unions, which are 61% of all credit unions in the U.S.,[300] are also exempt from sales taxes at state level. This was recognition of the fact that credit unions were first created as a form of financial institution that served financially-disadvantaged people who lack income and assets to access conventional banking services. As a congressional resolution in 1998 read, "Credit unions are exempt from federal taxes because they are member-owned, democratically-operated, not-for-profit organizations

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[295] A *community development credit union* (CDCU) is a credit union established for the primary purpose of serving particular financially-disadvantaged groups that have no access to commercial banking in the US.

[296] Clifford Rosenthal, "Credit Unions, Community Development Finance, and The Great Recession," Community Development Investment Center working paper 2012-01 (2012): 26.

[297] David M. Smith and Stephen A. Woodbury, "Withstanding a Financial Firestorm: Credit Unions vs. Banks," Filene Research Institute research brief (2010): 6.

[298] Ed Mayo, "The Hidden Alternative: Conclusion," in *The Hidden Alternative: Co-operative Values, Past, Present and Future*, ed. Anthony Webster et al. (Tokyo, Japan: United Nations University Press, 2012), 349.

[299] The I.R.S., Internal Revenue Manual: Part 7. Rulings and Agreements. Available at http://www.irs.gov/irm/part7/irm_07-025-014.html, accessed July 15, 2013.

[300] National Association of State Credit Union Supervisors (NASCUS), "State Cartered Credit Union Facts and Fiures," 2008. Available at http://www.nascus.org/facts_figures_archive/12_31_07_FactsFigures.pdf, accessed July 27, 2013.

generally managed by volunteer boards of directors, and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."[301]

Nonetheless, tax-free status falls short to explain the resilience of the credit union subsector against the commercial banking subsector. In the U.S. financial system, every third commercial bank has been given the same tax privileges as those for credit unions,[302] and these income tax-exempt banks called Subchapter-S banks already register 11% higher profitability than other commercial banks *before* taxation[303] – suggesting that superior profitability performance is attributable to factors others than tax priviledges such as better investment returns from assets owned.[304] Moreover, credit unions' tax priviledges have been offset by legal requirements that impose substantial restrictions on their ability to open accounts for depositors, grant loans to borrowers, and make investments as commercial banks do. This lost business volume points to high opportunity costs of the not-for-profit status, which challenges the credibility of the tax-advantage argument made about credit unions even though it can also explain credit unions' resilience to crises.

American Bankers' Association, a lobbying organization for U.S. banks points out that credit unions are also subsidized via regulations. It criticizes the 1998 Credit Union Membership Access Act, which relaxed membership requirements to credit unions –allowing credit unions to obtain scale advantages by means of faster growth. The association represents the perspective that, because credit unions are community-service organizations to satisfy their members' needs, they should not be allowed to

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[301] The US 105th Congress. Bill H.R. 1151 (Credit Union Membership Access Act) dated March 30, 1998.

[302] 2,368 of the 7,083 banking institutions in the US operate in subchapter S status. Sources: The Subchapter S Bank Association, available at http://www.subsbanks.org/faqs/how-many-subchapter-s-financial-institutions-are-there-in-the-united-states; and the Federal Deposit Insurance Corporation, available at http://www.fdic.gov/bank/statistical/stats/2012dec/industry.html, both accessed July 24, 2013.

[303] James Harvey and Jane Padget, "Subchapter S: A New Tool for Enhancing the Value of Community Banks," *Financial Industry Perspectives* (2000): 28.

[304] Ibid.

accept people outside of their communities defined in terms of an associational or professional commonality.[305]

This argument is challenged by the fact that commercial banks are not subject to any restrictions about whom they can accept as customers. Since banks are not exposed to such legal restrictions, the 1998 Act cannot be argued to have provided an advantage to credit unions that does not exist for commercial banks –it was simply another step in the liberalization of financial sector towards higher competition. The act furthered the wave of pro-market reforms that began with the “the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 [which] made commercial banks, savings banks and credit unions more similar by liberalizing product and price competition among depository intermediaries.”[306] Furthermore, the 1998 act’s impacts on the growths of credit union deposits and memberships have been moderate.[307] Accordingly, *unrestricted membership* argument appears to be a feeble proposition made to eliminate competition for commercial banking sector.

Other observers underline the differences in equity capitalization as a reason behind credit unions’ resilience. Admati and Hellwig point out commercial banks have higher propensity to borrow, which translates into diminished capacity to absorb shocks at times of losses from investments.[308] In the choice between issuing stock shares, retaining earnings and borrowing to raise funds, commercial banks typically choose borrowing as it is the only option with which they can serve their stockholders without using equity. In order to present organizational indebtedness favorably, the industry established return on equity (ROE) as the primary metric, by which performance of

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[305] American Bankers Association et al. v. NCUA, No. 2:05-cv-000904 (D. Utah, filed Nov. 1, 2006)).
[306] Surendra K. Kaushik and Raymond H. Lopez, “Profitability of Credit Unions, Commercial Banks and Savings Banks: A Comparative Analysis,” *American Economist* 40, no. 1 (1996): 66.
[307] Mark Ray Reavis, “The Long-term Impact of the Credit Union Membership Access Act on Credit Union Industry Growth” (PhD dissertation, NCU, 2014), 100.
[308] Anat Admati and Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It* (Princeton, NJ: Princeton Press, 2013).

banking executives have been judged. As increased liabilities translates into decreased equity in relation to assets in the balance sheet (denominator of the ROE formula), banking executives who personally benefit from leveraging resort mostly to debt for financing their organizations' investments.

More than 97% of the banks' asset portfolios have been funded by debt in America today. Consequently, when even moderate losses on investments occur, commercial banks struggle to remain afloat as they operate with a thin cushion against shocks. Because credit unions conform to the universal cooperative principle of retaining part of their earnings, they operate more with their owners' equity than outsiders' equity. As Kaushik and Lopez note, "Growth in the equity capital accounts of credit unions has been consistently more than double that of commercial banks since 1985, giving them a substantial advantage with regard to overall 'safety and soundness' compared with commercial and savings banks."[309]

In terms of stability, *fair value accounting* used by commercial banks is associated with an higher level of volatility is risk indications than the *historical cost* method used by credit unions.[310] Fair value accounting refers to the practice of valuing assets and liabilities at current market rates at the time of financial reporting. Also known as *mark-to-market accounting*, this valuation technique allows more current information on balance sheets and provides more reliable information to investors, but it also increases volatility. In a 2004 paper, which predicted the meltdown in 2007; Cifuentes, Ferucci and Shin wrote: "When the market's demand for illiquid assets is less than perfectly elastic, sales by distressed organizations depress the market prices of such assets. Marking to market of the asset book can induce a further round of endogenously

[309] Kausnik and Lopez, 66.
[310] William M. Isaac, Securities and Exchange Commission Roundtable on Mark-to-Market Accounting. Available at http://www.sec.gov/comments/4-573/4573-79.pdf, accessed July 27, 2013.

generated sales of assets, depressing prices further and inducing further sales."[311] As conservative financial organizations, credit unions refrain from the practice of *mark-to-market accounting* that exacerbates contagion effect experienced in persistent macroeconomic contractions. Instead, they value their assets and liabilities by the historical prices at which they accumulated them at the time of the original transaction. Consequently, drops in asset prices do not influence their balance sheets as they do banks' balance sheets, and credit unions operate with a greater level of stability in their accounting –helping them accomplish their goal of serving their members on favorable terms stably.

Worrell points out that personal relationship embedded in credit unions' local character is an explanatory factor behind the long-term stability of credit unions.[312] He explains that in an increasingly competitive field of global finance, banks "become more impersonal and more inflexible in their approach to lending. This is not something that is welcomed either by banks or their customers, but it is an inevitable consequence of large size and increasing complexity. […] The most successful banker in the long run is the banker who has the largest portfolio of dependable borrowers who are known to have the willingness and ability to service their borrowings on time. The best way to establish the borrowers' credentials is to build a relationship with them so that they may establish a track record that speaks to their competence and prudence. However, big banks with wide networks find it difficult to do this in today's dynamic world. Instead they must rely mainly on rules of thumb, credit limits, credit scoring, collateral and similar tools."[313] Success of the *microcredit* initiative in Bangladesh confirms the strength of social relations as a motivational factor to prevent loan defaults in finance. Earning a Nobel Peace Prize to its pioneer Muhammad Yunus, the practice of providing business

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[311] Rodrigo Cifuentes, Gianluigi Ferrucci and Hyun S. Shin. "Liquidity risk and contagion," *Journal of the European Economic Association* 3 (2005): 556.
[312] Bank for International Settlements, "DeLisle Worrell: Credit unions have a competitive edge," http://www.bis.org/review/r131009f.pdf.
[313] Ibid.

loans to financially-disadvantaged people by using social shame from defaulting as a collateral has reportedly lifted thousands of people out of poverty, reduced unemployment, and improved gender inequality and children's' conditions around the world.[314]

2.4 Organizational Differences and Managerial Risk Tolerance

This section examines the differences in organizational purpose of commercial banks and credit unions as an explanatory factor of stability in financial sector. Economic actors redefine rationality at every context in which they find themselves to make a decision. They may display a calculating, material-interest maximizing frame of mind when they act in a commercial capacity (such as a businessperson), however, they would involve a unique combination of material and non-material interests in their line of thinking at each decision mode on which they are to decide in other capacities (such as administrators, non-profit managers, philanthropists, consumers, parents or professionals). Therefore, (explicit) organizational purpose of the employers, for which they work, provides a contextual influence on executives in recomposing material and non-material considerations in administrative decision-making. From this proposition emerges an argument that unique organizational purpose of cooperative banks could provide a contextual incentive for financial executives to adopt a more conservative/risk-averse managerial style –driving cooperative banks towards higher stability than commercial banks.

2.4.1 Design Differences between Commercial Banks and Credit Unions

Commercial banks and credit unions are two types of financial organizations that compete in the same sector with different organizational structures (Table 1).

[314] Abul Bashar Bhuiyan, "Microcredit and Sustainable Livelihood: An Empirical Study of Islamic and Conventional Credit on the Development of Human Capital of the Borrowers in Bangladesh," *Journal of Economic Cooperation & Development* 34, no. 3 (2013): 113.

Commercial banks in North America are publicly-trading corporations owned by their stockholders. Funded largely by stock sales, they exist to maximize their share value by means of profit maximization and perception management (stock trading). Each stockholder's voting power is determined by the number of shares he/she owns, which makes shareholder meetings a convention with a heterogeneous distribution of power. Stockholders elect board of directors, which in turn appoint executives to administer daily operations of the company. These three organs solely pursue stockholders' pecuniary interests, and do so as a separate class than other stakeholders of the company who are influenced by operations of the company -employees, customers, vendors, traders and the local government.

On the other hand, credit unions are not-for-profit cooperatives that are democratically-owned-and-controlled by their local stakeholders. They are organizations established and expanded by members for the purpose of satisfying each other's financial needs. Because credit unions do not issue tradable shares, they are owned solely by their depositor, borrower and employee members. They observe *one member-one vote principle*, which allows any eligible person who opens an account to be an equal owner with the same voting rights as previous owners –irrespective of the size of his/her deposit. Credit union executives are professional bankers[315] who are appointed (amongst their members, or from outside) by boards of directors who are volunteer members elected annually by all members. Credit unions do not operate for *profit maximization*, and they raise funds mostly by their members' deposits. Their members are local people who are parts of a particular community as defined in their bylaws – main categories used to describe communities are employment (such as Harvard University Employees Credit Union), residency (San Diego County Credit Union), or professional affiliation (Navy Federal Credit Union).

[315] "Total Compensation Report: CEO," CUNA report (Credit Union National Association, 2014), http://www.cuna.org/WorkArea/DownloadAsset.aspx?id=66007 (accessed October 11, 2014).

Table 1. Features of credit unions and commercial banks[316]

	Credit unions	Commercial banks
Structure:	Not-for-profit cooperative	For-profit corporation
Organizational purpose:	Provide members favorable interest rates in a stable way	Maximize share value
Profit purpose:	Make profits to sustain and improve benefits to stakeholders	Maximize profits to maximize value for shareholders
Use of profits:	Used to offer lower interest rates on loans and higher interest rates on deposits	Distributed to stockholders as dividend, and used to improve market capitalization
Ownership:	Owned by stakeholders (depositors, borrowers and employees)	Owned by stockholders
Funding source:	(Mostly) Member deposits	(Mostly) Stock sales
Clientele:	Community members All income levels	Anyone Mostly middle to high income levels
Governance:	By professional bankers (executives) hired by board of directors who are elected by members from the pool of volunteering members	By professional bankers (executives) hired by board of directors who are hired by stockholders from the pool of available professionals from outside
Voting rights:	One person-one vote	One share-one vote
Products and services:	Full service (Savings,	Full service (Savings,

[316] Adopted from "What is a Credit Union?" World Council of Credit Unions, accessed July 17, 2014, http://www.woccu.org/about/creditunion.

	credits, insurance and investments)	credits, insurance and investments)
Service delivery:	All mediums (Main office, shared branching, ATMs, POS devices, PDAs, cell phones, Internet)	All mediums (Main office, shared branching, ATMs, POS devices, PDAs, cell phones, Internet)
Local identity?	Yes	No

Credit unions are community organizations that restrict their membership to members of their communities, and they aim to serve all socioeconomic segments of the society that are parts of the defined community. Commercial banks have no eligibility requirements for patronage, and they generally target middle and high income households. In credit unions, profits are used to offer higher interest rates to deposit accounts and lower interest rates to loans while commercial banks distribute their profits to their stockholders as dividend payments and use their profitability to improve their market capitalization. The two organizations differ minimally in terms of products and services they offer, and the mediums by which they offer them; however, credit unions have a more localized character and focus than commercial banks, which seek and spread to other profitable markets with minimal regard for their locations.

Differences between the ways credit unions and commercial banks are organized are also associated with a number of challenges for cooperative banking. Branch and Baker identify these governance issues as *principal-agent problem* and *borrower dominance problem*.[317] In credit unions, governance is divided into four functions and roles:

. general assembly, in which all members vote for the board of directors –among other issues,

[317] Brian Branch and Christopher Baker, “Overcoming Credit Union Governance Problems: What does it take?” *IFM Review* 7, no. 2 (2002): 1.

. board of directors, in which members elected by the general assembly provide general direction for the credit union including decisions about hiring, firing and compensating managers.

. management, which is composed of financial professionals from inside or outside of the credit union who handle daily operations of the union, and

. supervisory committee, composed of members who perform periodic regulatory supervision to ensure that the credit union complies with its bylaws and the larger laws that apply to it.

Authors observe that this member-controlled governance structure in credit unions is counter-productive as well as democratic.[318] Because credit union members are typically middle-to-low income individuals, boards of directors they choose among volunteer members are likely to determine executives' compensation at levels comparable to their own incomes. As credit unions compensate their executives significantly less than the rest of the industry (about one 30th of commercial banks, as previously mentioned), they struggle to attract financiers with utmost talent and responsibility as managers. Moreover, the fact that credit union structure gives members with limited financial knowledge the responsibility to supervise the executives may result in a diluted sense of responsibility among executives. Consequently, the *principal-agent problem*, which refers to a management's incomplete service to stakeholders' interests, can become as pronounced in credit unions as they are in commercial banks.

Furthermore, credit unions' member-controlled governance may result in dilution of fiduciary responsibility.[319] Thousands of members, each of whom has only one vote regardless of their contribution to the organization may feel discouraged to carry out their membership duties as members, directors or supervisors of the union, and accordingly, professionalism inside the organization ends up being compromised.

[318] Ibid., 9.
[319] Ibid., 11.

Boards of directors, which consist of volunteer members, can also create hazardous influence on executives. As in general membership body, boards of directors include members who are linked to the credit union in the capacities of depositors or borrowers. Because these two types of members have different interests, executives may feel challenged with the pressure from depositor members who want profits to be used to increase interest rate on savings, and the pressure from borrower members who prefer profits to be used to decrease interest rates on loans. Authors observe that “[…] borrower-dominated credit unions operating in an environment that lacks clear governance provides a temptation for improper manipulation of the credit granting process by directors.”[320]

2.4.2 Organizational Design and Risk Tolerance

Different organizational designs of commercial banks and credit unions incentivize their leaderships to adopt different levels of risk appetite.[321] Because maximizing shareholders’ value is their ultimate purpose, executives in commercial banks treat risk as an essential enabler of profit maximization, which helps them accomplish their organizational mission. Distribution of profits to shareholders as dividends further compels bank executives to embrace risk-taking as a positive leadership trait. On the other side, credit union executives follow a more conservative attitude towards risk, because their performance is evaluated according to earnings (59.6%), board evaluation (51.6%) and loan growth (43%),[322] and credit union profits are used to offer more favorable interest rates to members.[323] This corporate culture

[320] Ibid., 17.
[321] Mónica López-Puertas Lamy. “Commercial banks versus Stakeholder banks: Same business, same risks, same rules?” European Association of Cooperative Banks Young Researchers Award (2012).
[322] Scott Dettmann and Bob Cartwright, "2013 CUES Executive Compensation Survey", (Credit Union Executives Society, Madison, WI, 2013), http://www.cues.org/repository/ExecSummaryFinal-2013.pdf.
[323] Jeff Heinrich and Russ Kashian, “Credit Union to Mutual Conversion: Do Rates Diverge?” University of Wisconsin-Whitewater working paper no. 06-01 (2006).

spells a healthy perception of profits, which values them no more than a means to help out members in their financing needs.

Accordingly, credit unions avoid volatile instruments or accounting techniques like *mark-to-market asset valuations*. Their reluctance for subprime lending, which led commercial banks to the brinks of collapse in the recent episode, was proven to be a prudent approach over the course of the financial crisis. In an examination of resilience to economic contractions, Smith and Woodbury conclude that "Banks and credit unions have different loan portfolios and differ in their resilience to business conditions for the same reason—they differ in the degree to which they seek out and are willing to accept risk."[324] Crear adds that instruments like "subprime mortgage loans characterized by high interest rates with large interest rate resets, negative amortization, lack of sufficient underwriting and other indicators of fraud" are incompatible with "credit unions' generally conservative lending practices and philosophical mandate to place member needs ahead of institutional profits."[325]

A study published before the crisis in 2007 revealed that for-profit commercial banks are inclined to keep minimal amounts of capital to cover their potential losses. In their analysis of the spread between *regulatory capital* (the minimum capital required by the law) and *economic capital* (the capital level bank administrations would prefer if they were free to determine it on their own), Elizalde and Rapullo found that the two capital levels are partially exclusive. Although regulators seek to minimize the spread between the two capital levels, banks do not appear to acknowledge the virtues of keeping economic capital levels close to regulatory capital requirements. The authors concluded that "there does not exist a direct relationship between [the two] capital levels. […] regulatory (but not economic) capital depends on the confidence level set by the regulator, while economic (but not regulatory) capital depends on the intermediation

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[324] Smith and Woodbury, p. 7.
[325] The World Council of Credit Unions, Cooperative Banks, Credit Unions and the Financial Crisis. Available at www.un.org/esa/socdev/egms/docs/2009/cooperatives/Crear.pdf, accessed July 21, 2013.

margin and the cost of bank capital. These last two variables play a key role in determining the differences between economic and regulatory capital."[326]

Credit unions, on the other hand, have significantly lower rates of delinquency (inability to meet obligations) and charge-offs (use of insurance funds due to severe delinquency) than commercial banks do (52% and 77% of banks, respectively).[327] In their comparative analysis of the data between 1986 and 2009, Smith and Woodbury found that "Banks and credit unions have different loan portfolios and differ in their resilience to business conditions for the same reason –they differ in the degree to which they are willing to accept risk."[328] Authors suggest that financial sector regulations should take this conclusion into account, and reduce capital reserve rates required from credit unions to levels that are below those mandated on commercial banks.

In commercial banks, segregation of management/ownership and other stakeholders as two separate classes manifests itself in compensation structure. The fact that organs that exist to serve stockholders make decisions on executive compensation results in stock-option plans being positioned as a stable component of compensation packages in corporate America. Making a large portion (as high as 92%)[329] of executive compensation by equity is beneficial for all three of the decision-making organs. Regularly scheduled, large scale purchases on the company's own stock (on average, 10.3% of corporate earnings are spent to executive compensation,[330] which is 296 times

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[326] Abel Elizalde and Rafael Repullo, "Economic and Regulatory Capital in Banking: What is the Difference?" *International Journal of Central Banking* 3 (2007): 111.
[327] David M. Smith and Stephen A. Woodbury, "Withstanding a Financial Firestorm: Credit Unions vs. Banks," Filene Research Institute research brief (2010): 7.
[328] Ibid.
[329] Lucian Bebchuk and Yaniv Grinstein, "The Growth of Executive Pay", (working paper, John M. Olin Center for Law, Economics and Business, Harvard University, Cambridge, MA, 2005), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Bebchuk_et%20al_510.pdf.
[330] Ibid.

the average salary in U.S. companies)[331] applies upward pressure on companies' stock prices. It increases companies' market capitalization, which in turn provides the company greater ability to retain its top executives. Despite its benefits for the management/shareholders, stock-option plans encourage excessive risk-taking among financial executives.[332]

Equity-based bonuses further increase risk incentives for leaderships in commercial banks. Executives whose performances in increasing the company's share value are rewarded with bonuses are encouraged to take excessive risks. Crotty likens executives who are largely paid by non-salary means to *rainmakers* who have nothing to lose from making positive predictions: It is "[…] rational for rainmakers to use unsustainable leverage to invest in recklessly risky assets in the bubble […] since boom-period bonuses do not have to be returned if rainmaker decisions eventually lead to losses for their firms, and since large bonuses continue to be paid even when firms in fact suffer large losses."[333]

Conflict of interests created by the value-based compensation structure also leads to the *golden parachute* phenomenon –another risk-incentive for executives. Written and signed by executives and boards of directors, employment contracts of executives often include clauses that allow for hefty compensation of executives in the case of departure from the company. Enormous exit bonuses delivered to executives as a result of their failure provide perverse incentives for excessive risk-taking. Wade et al. who analyzed 89 Fortune 500 corporations found that corporate boards with more outsiders offer larger

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[331] Lawrence Mishel and Alyssa Davis, "CEO Pay Continues to Rise as Typical Workers Are Paid Less", (issue brief no. 380, Economic Policy Institute, Washington, DC, 2014), http://s1.epi.org/files/2014/ceo-pay-continues-to-rise.pdf.
[332] Melissa A. Williams and Ramesh P. Rao, "CEO Stock Options and Equity Risk Incentives," *Journal of Business Finance and Accounting* 33 (2006): 26-44.
[333] James R. Crotty, "How Bonus-Driven 'Rainmaker' Financial Firms Enrich Top Employees, Destroy Shareholder Value and Create Systemic Financial Instability," in *After the Great Recession: Keynesian Perspectives on Prospects for Recovery and Growth*, eds. Barry Z. Cynamon, Steven M. Fazzari and Mark Setterfield (New York: Cambridge Press, forthcoming).

golden parachutes, which these pay packages are "associated with increased takeover risk" for companies.[334]

Bank executive compensation packages are largely based on equities, include golden parachute bonuses, and total to be $7.8 million on average.[335] Executive compensations in credit unions, on the other hand, do not offer equities or exit bonuses,[336] and are worth $256,339 on average. Birchall implies that this difference, which had been considered as positive incentives for management in commercial banking, ought to be questioned as a source of perverse incentives for excessive risk-taking in finance: "Before the crisis, economists said financial cooperatives were bound to be less efficient than investor-owned banks because they did not reward their managers with shares. Now the thinking is, this is great, we shouldn't be rewarding managers with shares because managers will then take high risk strategies, bail out five years later as multi-millionaires and leave the banks to go bankrupt."[337] Vast differences in compensation structure and the executive priorities they set are also found to be associated with significantly lower quality of service in commercial banks vis-à-vis credit unions.[338]

Another organizational feature of credit unions that influences the risk attitude of their executives is the fact that credit unions, as financial cooperatives, do not issue tradeable ownership shares. In expansionary periods during which asset prices rise, credit unions cannot raise equity by selling its shares as their commercial competitors do. While this inability translates into slower growth prospects for credit unions, it also

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[334] James Wade, Charles A. O'Reilly and Ike Chandratat, "Golden Parachutes: CEOs and the Exercise of Social Influence," *Administrative Science Quarterly* 35 (1990): 587.
[335] Rüdiger Fahlenbracha and René M. Stulzb, "Bank CEO incentives and the credit crisis," *Journal of Financial Economics* 99 (2011): 16.
[336] Scott Dettmann and Bob Cartwright, "2013 CUES Executive Compensation Survey", (Credit Union Executives Society, Madison, WI, 2013), http://www.cues.org/repository/ExecSummaryFinal-2013.pdf.
[337] "What financial cooperatives can teach the big banks," *The International Labor Organization*, November 5, 2012, sec. Comment and Analysis.
[338] Antony T. Allred and H. L. Addams, "Service quality at banks and credit unions: what do their customers say?" *Managing Service Quality* 10, no. 1 (2000): 52-60.

prevents excessive growth that conceals unjustifiable risk-taking. Recent financial crisis demonstrated that financial institutions become less manageable when their portfolios become highly complex. Larger a financial institution is, more diverse and complex its asset portfolio becomes, which compromises the management's capacity to administer and monitor the portfolio prudently. In the U.S. financial system in which similar numbers of credit unions and banks operate (approximately 7,000 credit unions and 6,000 banks), seven largest banks by asset size[339] control 70% of all assets in the system[340] whereas seven largest credit unions by asset size[341] control a mere 1.2% of the assets.

A St. Louis Federal Reserve paper noted that excessive concentration of assets and diversification of operations constitute a systemic threat to the U.S. economy, and they have to be curbed by "incremental reforms such as the The 2010 Dodd-Frank Act, which includes living wills for orderly dissolution, capital requirements, stress tests, risk-based assessments on deposit insurance, FDIC orderly liquidation authority, the Volcker Rule and investor protections, or radical reforms such as caps on assets or deposits."[342] While opportunities for scale and scope economies, and motivations to diversify and comply with legal requirements increasingly compel smaller credit unions to resort to acquisitions and mergers,[343] acquiring side is nearly twice as large in comparison to the acquired side in banks (%7.9)[344] versus credit unions (4.4%)[345] –

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[339] Dafna Avraham, Patricia Selvaggi and James Vickery, "A Structural View of U.S. Bank Holding Companies," *Federal Reserve Bank of New York Economic Policy Review* 18, no. 2 (2012): 71.
[340] The U.S. Department of Commerce, "The Financial Services Industry in the United States," http://selectusa.commerce.gov/industry-snapshots/financial-services-industry-united-states.
[341] Caroline P. Jervey, *Top 100 Credit Unions in Over 100 Categories* (Coral Gables, FL: Bauer Financial, 2013), 2.
[342] The Federal Reserve Bank of St. Louis, "The Big Banks: Too Complex To Manage?" *Central Banker* (2012).
[343] Deloitte, "Survival of the Fittest: How Credit Unions Can Stay Competitive in a Changing Industry?" (2010).
[344] The U.S. Federal Reserve System, *Bank Merger Activity in the United States 1994-2003,* by Steven J. Pilloff, Staff Study 176 (Washington, DC: Federal Reserve, 2004), 7.
[345] James A. Wilcox and Luis G. Dopico, "Credit Union Mergers: Efficiencies and Benefits," FRBSF Economic Letter 28 (2011): 3.

indicating a higher concentration of assets at the top in the bank subsector compared to the credit union subsector. A St. Louis Federal Reserve paper points out that credit unions have been an attractive option for American consumers: "Households respond to increased concentration among local banks by moving accounts to credit unions."[346]

Credit unions' conservative approach to risk taking also linked their characteristic as *self-insuring* businesses. While deposits in commercial banks are insured by FDIC (Federal Deposit Insurance Corporation), which is funded by taxpayers, deposits in credit unions are insured by NCUSIF (National Credit Union Share Insurance Fund) funded by credit unions themselves.[347] Congruent with the universal cooperative principal of cooperation with other cooperatives, credit unions transfer 1% of the deposits they receive to NCUSIF as a contingency measure. This mechanism allows credit unions to not be a burden on public finance as deposits in failed credit unions are paid back using the NCUSIF funds created by all credit unions – rather than being absorbed by taxpayers as in commercial bank failures. This structure also eliminates a moral hazard existent in the commercial banking subsector. In commercial banks, proceeds from an investment project accumulate solely for shareholders whereas the losses in the case of failure are assumed only partly by shareholders. This mismatch between potential gains and losses for shareholders does not exist in credit unions whose depositors are insured, but are also the same people as the owners.[348]

Predictably, commercial banks registered colossal failures during the Great Recession –costing taxpayers enormous sums of money in terms of FDIC paybacks and rescue packages. In 2010 alone, 157 banks failures marked a 17-year historical high as

[346] William R. Emmons and Frank A. Schmid, "Bank Competition and Concentration: Do Credit Unions Matter?" *Federal Reserve Bank of St. Louis Review* 82/3 (2000): 39.
[347] FDIC coverage limit is $250,000 for all account types, and NCUSIF coverage limit is $250,000 for certain retirement accounts and $100,000 for other accounts.
[348] Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics* 3 (1976): 334–37.

860 other banks were admitted in the FDIC's institutions with bankruptcy risk. Government rescues of only Bank of America and Countrywide Financial have cost $1.9 trillion while FDIC registered a negative balance of $8 billion at the end September in 2010.[349] Furthermore, insurance losses are typically much larger in FDIC than they are in NCUSIF. Prior to the subprime crisis, fund ratio was a (-0.28%) at FDIC but 1.3% at NCUSIF.[350] This reality translates into higher costs to bank depositors as banks' FDIC insurance costs are estimated to be 60% higher than credit unions' insurance costs with NCUSIF.[351]

2.5 Empirical Analysis

2.5.1 Quantifying Organizational Risk Appetite: Composite Managerial Risk Indicator (CMRI)

To examine the relationship between organizational rationality and risk tolerance, this chapter analyzes data from the financial sector in Canada. Canadian finance is a suitable choice for a comparative analysis of credit unions and commercial banks for a number of reasons: it is a financial system where credit unions carry a high level of significance, and its general characteristics are compatible with those of the U.S. system where the Great Recession that inspired this dissertation occurred. Its reputation as the soundest financial sector in the world[352] makes credit unions' contribution to financial stability more observably pronounced. Lastly, high professionalism of financial sector and the national significance of credit unions translate into high data quality and

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[349] David S. Hilzenrath, "2010 worst year for bank failures since 1992," *The Washington Post*, sec. Business, December 28, 2010.
[350] Bill Hampel, "Comparing FDIC and NCUSIF," available at https://www.utahscreditunions.org/vendors/images/FDIC%20vs%20NCUSIF.pdf, accessed July 22, 2013.
[351] Ibid.
[352] Tony Porter, "Canadian Banks in the Financial and Economic Crisis" (paper presented at the Policy Responses to Unfettered Finance Workshop by North-South Institute, Ottawa, June 2010), http://www.nsi-ins.ca/wp-content/uploads/2012/10/2010-Canadian-Banks-in-the-Financial-and-Economic-Crisis.pdf.

availability –making it possible to retrieve comprehensive data needed for a multidimensional analysis that combines cross-section and time-series aspects.

Canadian financial sector became the only financial sector within the G7 economies that did not need a government bailout –and it remained profitable during the Great Recession. Porter credits conservatively set capital requirements, a low leverage cap, and prudentially enforced regulations, and a risk-averse culture at their sociological core in Canada's success.[353] Another factor is policy networks that respond to misbalances in a cooperative spirit with the corporate sector.[354] Calomiris links this tradition to Canada's background in French colonialism whose legacy has become a "highly-centralized federal government which controlled economic policymaking and had built-in buffers for banker interests against populist forces."[355] Just as a secular state keeping religious and government separate, Canada's welfare state keeps corporate interests away from public service. It is illegal for financial corporations to lobby public officials in Canada, and corporate contributions to election campaigns are strongly restricted.

In order to construct an empirical model to examine whether commercial banks and credits unions have intrinsically different propensities for risk tolerance, these organizations' exposure to risk need to be identified quantitatively. Canadian Central Bank, *the Bank of Canada* recognizes four balance sheet items as indicators of risk

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[353] Porter, p. 3-6.
[354] Ian Roberge, "Explaining Canadian Resilience to the Global Financial Crisis: The Role of Policy Networks, Regulation in the Age of Crisis" (paper presented at the Third Biennial Conference of te European Consortium for Political Research Regulatory Governance Standing Group, Dublin, June 2010), http://regulation.upf.edu/dublin-10-papers/2A4.pdf.
[355] Charles W. Calomiris, "The Political Foundations of Scarce and Unstable Credit" (paper presented at the Federal Reserve Bank of Atlanta Financial Markets Conference 2013, Atlanta, April 2013), http://www.frbatlanta.org/documents/news/conferences/13fmc_calomiris.pdf.

propensity in financial institutions:[356] *Leverage ratio, (Tier 1) capital ratio, liquidity ratio* and *funding ratio*.

Leverage ratio shows the extent to which a financial institution's assets were purchased with borrowed money.[357] Higher leverage indicates larger dependency to macroeconomic conditions in sustaining the asset base, which is a risk factor. *Tier1 capital ratio* defines a financial institution's ability to cover its risk-weighted assets with owners' equity and reserves. It was created and promoted by the Basel Committee on Banking Supervision –a Swiss-based organization comprised of central bank governors in ten leading economies. The committee's decision was a response to criticisms that the previously-used Tier 2 ratio had relied on subjectively-quantified Tier 2 capital. Also known as "supplementary capital," Tier 2 capital had included undisclosed reserves, revaluation reserves, general loan-loss reserves, hybrid (debt/equity) capital instruments, and subordinated debt. In a 2006 brief, the committee announced that "They [elements of Tier 2 capital] may be inherently of the same intrinsic quality as published retained earnings, but, in the context of an internationally agreed minimum standard, their lack of transparency, together with the fact that many countries do not recognize undisclosed reserves, either as an accepted accounting concept or as a legitimate element of capital, argue for excluding them from the core equity capital element,"[358] and initiated Tier 1 ratio as a more sophisticated risk indicator that distinguishes different types of capital and assets. A larger value for Tier 1 capital ratio points to larger coverage for risk-weighted assets, indicating higher managerial prudence.

[356] David X. Chen et al. "An Analysis of Indicators of Balance-sheet Risks at Canadian Financial Institutions," *Bank of Canada Review* (2012): 24.
[357] Katia D'Hulster, "The Leverage Ratio," World Bank/International Finance Corporation policy brief (2009). Available at http://www.worldbank.org/financialcrisis/pdf/levrage-ratio-web.pdf, accessed July 2, 2013.
[358] Bank for International Settlements, Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards* (Basel, Switzerland: Bank for International Settlements Press & Communications, 2006), 14.

Liquidity ratio and *funding ratio* are two newer concepts inspired by indicators proposed in Basel-III guidelines.[359] Chen et al. describe *liquidity ratio* as a buffer shown by the total value of cash, cash equivalents, public securities, and secured short-term loans per dollar of assets: “Higher the asset-liquidity ratio, more an institution is able to withstand adverse shocks that increase the need to liquidate assets.”[360] *Funding ratio* is a measure of reliability of capital that funds the assets, and refers to the size of wholesale (non-personal) deposits and repurchase agreements in relation to total assets.

Financial meltdown in the U.S. economy revealed insufficiency of each of these measures as a risk indicator alone. At the end of 2008, Tier 1 capital ratio, which was the most frequently used risk indicator at the time, had been 9.4% of risk-weighted assets, and its spread to the 4% benchmark was thought to indicate overcapitalization against the default risk.[361] Similarly, over the four years preceeding the crisis, conventional indicator of leverage showed stable and even declining rates of leverage for the commercial banks in the U.S. even though these banks’ exposure to economic and embedded leverage were actually increasing.[362] This failure was an outcome of leverage ratio’s incapability to keep up with the changing nature of modern finance. Since the 1990s, new instruments that transfer credit risk by dividing and repackaging them as securities (such as structured credit products) have become common tools for financial institutions. Facilitating banks’ funding of long-term assets with short-term liabilities, these instruments increased banks’ exposure to credit and liquidity risk, however this exposure they created were not captured by the leverage ratio that focuses solely on the conventional items of leverage.

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[359] International Regulatory Framework for Banks (Basel III), The Bank for International Settlements. Available at http://www.bis.org/bcbs/basel3.htm, accessed July 24, 2013.
[360] David X. Chen et al. “An Analysis of Indicators of Balance-sheet Risks at Canadian Financial Institutions,” *Bank of Canada Review* (2012): 24.
[361] Michele Fratianni and Francesco Marchionne, “The role of banks in the subprime financial crisis,” *Review of Economic Conditions in Italy* 1 (2009): 22.
[362] Katia D’Hulster, “The Leverage Ratio,” The World Bank policy brief no.11 (2009). Available at http://www.worldbank.org/financialcrisis/pdf/levrage-ratio-web.pdf.

The Bank for International Settlements identifies a number of weaknesses in the ratio for liquidity coverage.[363] As an instrument that shows balance sheet items in a particular currency, liquidity ratio fails to inform about the currency risk, to which assets and liabilities denominated in other currencies are exposed. Because liquidity needs in each currency is different, the ratio drives financial institutions to operate under the assumption that convertibility and transferability of different currencies would be the same at times distress as they are in expansionary periods. Moreover, lack of international regulations to mandate frequent reporting (weekly) of liquidity ratio to financial regulators spells the incapability of this ratio to function as a risk indicator alone. Accordingly, this ratio failed to warn the policymakers about the upcoming crisis over the years leading to 2007.

Funding ratio is not an indicator that regulators can rely solely on to ensure institutional stability in finance.[364] It detects exorbitant maturity transformation risks that exist up to only one year –it does not promote more stable funding for illiquid assets that have a remaining maturity of more than a year. Its functionality in providing comprehensive information is limited given that it is criticized to be an intrusive measure that could impair financial institutions' capacity to transform liquidity into maturity. Its use as a single indicator of risk could motivate financial institutions to reduce their exposure to long-term financing, which allows loans with maturities less than a year to dominate the credit market –deteriorating borrowing conditions and growth prospects in the economy.

Insufficiency of individual balance sheet risks to provide confident guidance led to a rapid expansion of the literature on early warning systems (EWS) over the last

[363] Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools," The Bank for International Settlements policy brief (2013). Available at https://www.bundesbank.de/Redaktion/EN/Downloads/Tasks/Banking_supervision/Basel_Committee/2013_01_basel3_liquidity_coverage_ratio_liquidity_risk_monitoring_tools.pdf?__blob=publicationFile.
[364] Gobat, Jeanne; Mamoru Yanase, and Joseph Maloney. 2014. The Net Stable Funding Ratio: Impact and Issues for Consideration. Working Paper, The IMF, Washington, DC.

several years. In response to increasing fragility in financial sectors due to increasing international mobility of capital and leveraging around the world, a number of composite indicators have been introduced. Nevertheless, political considerations compromise the process to use these indicators in financial policymaking and regulations decisively.[365] Even though many international organizations and central banks keep track of stress in financial sectors –IMF, European Central Bank, Czech Central Bank, and National Bank of Hungary are a few,[366] policymakers typically display reluctance in relying on them due to the high costs of predicting banking crises incorrectly. In the face of insufficient political will to use risk stress tests in shaping policies, public officials have conventionally treated this literature as rough indicators with limited policy relevance, and utilized only those measures with an economy-wide perspective. A recent study by SEACEN (South East Asia Central Banks Research Center) reads

> "In response to the global financial crises in the 1980s and 1990s, national and international institutions started to monitor the soundness of the financial system more intensively. A wide range of instruments/indicators is used to assess financial system stability in analytical practice. […] Composite indicators in the form of the banking soundness index, the financial stress index, financial stability index and financial stability maps are used by the authorities to gauge financial stability.[367] […] However, the use of composite indicators is not widespread in Financial Stability Reports published by central banks which extensively focus on sector specific indicators and macro economic variables to assess stability."[368]

For financial systems to be supported by more stable financial institutions, individual risk indicators of these institutions should be blended into a single, politically-feasible composite indicator that can inform the markets, central banks, regulators and the public about the soundness of balance sheets in the financial sector more comprehensively than individual indicators do. Such a composite measure would be

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[365] E. Philip Davis and Dilruba Karim, "Comparing early warning systems for banking crises," *Journal of Financial Stability* 4 (2008): 89.
[366] International Finance Corporation. *Measures of Financial Stability: A Review* by Blaise Gadanecz and Kaushik Jayaram. Basel, Switzerland: Bank for International Settlements, 2009. http://www.bis.org/ifc/publ/ifcb31ab.pdf (accessed February 23, 2014).
[367] Yuthika Indraratna (ed.), *Strengthening Financial Stability Indicators in the Midst of Rapid Financial Innovation: Updates and Assessments*, (Kuala Lumpur: SEACAN Centre, 2013), iii.
[368] Ibid., 5.

instrumental for investors to assess the prospects financial institutions represent, for regulators to establish guidelines for systemic stability and enforce them, and for policymakers to monitor the delicate balance between risk and growth in a reliable fashion.[369] It would also allow annual risk rankings of financial institutions to be prepared and announced so the general public could evaluate their banking options for safety and viability. Such rankings would open a new line of competition for financial organizations, and encourage them to offer their clients lower organizational risk as the trustees of their money –in addition to conventional tools of competitive advantage like better interest rates or service. In an increasingly complex and intertwined financial world, comprehensive risk measures would supplement traditional methods of bank assessment such as perceived quality of service or name recognition with a more objective and performance-based criterion, and allow more informed decisions for economic actors. Construction of these measures out of the indicators that have already been utilized by policymakers (such as the four ratios given above, which are used by the Canadian Central Bank) would have a larger appeal for policymakers to tolerate political concerns about their use.

This dissertation makes use of a single aggregate measure under the name *Composite Managerial Risk Indicator* (CMRI). CMRI blends the four balance sheet risks identified above with minor algorithmic changes made to them for the sake of interpretive consistency. Because CMRI endeavors to point to risk appetite in financial institutions, its constituent elements ought to be realigned so their higher values would indicate higher risk levels. To convert the four indicators into ratios that positively correlate to higher risk appetite, new ratios are derived while remaining committed to the subject ratios' original spirit.

Leverage ratio: Total assets / (Total owner's equity + Subordinated debt)

[369] Holló, Dániel; Manfred Kremer and Marco Lo Duca. 2012. CISS: A Composite Indicator of Systemic Stress in the Financial System. Working Paper, European Central Bank, Frankfurt, Germany.

gives way to

Reverse leverage ratio: 1 / Leverage ratio

= (Total owner's equity + Subordinated debt) / Total assets

and to

Leveraged assets ratio (LAR): 1- Reverse leverage ratio

= 1 - (Total owner's equity + Subordinated debt) / Total assets

Similarly,

Tier 1 capital ratio: Adjusted net Tier 1 capital / Total risk-weighted assets

leads to

Capital inadequacy ratio (CIR): 1- Tier 1 capital (adequacy) ratio

= 1 - Adjusted net Tier 1 capital / Total risk-weighted assets

Likewise,

Asset liquidity ratio: (Cash and cash equivalents + Public securities + Secured short-term loans) / Total assets

leads to

Asset illiquidity ratio (AIR): 1 – Asset liquidity ratio

= 1 - (Cash and cash equivalents + Public securities + Secured short-term loans) / Total assets

And finally,

Funding ratio: (Non-personal deposits + Repos) / Total assets produces

Mobile funding ratio (MFR): 1 - Funding ratio

= 1 - (Non-personal deposits + Repos) / Total assets

CMRI is then built as a composite indicator that blends the four risk indicators by applying equal weights to each indicator. This approach conforms to the approach in financial sector risk literature, which welcomes homogenous attribution of significance across risk indicators. As the Bank for International Settlements notes, "the variance-equal method […] is the one most commonly used in the literature and consists of normalising each variable and then assigning equal weights."[370]

Each of the four ratios is indexed across all observed organizations and time periods, and incorporated into the composite index.

$CMRI_{i,t}$ = 0.25 Leverage Assets Ratio $Index_{i,t}$ + 0.25 Capital Inadequacy Ratio $Index_{i,t}$ + 0.25 Asset Illiquidity Ratio $Index_{i,t}$ + 0.25 Mobile Funding Ratio $Index_{i,t}$
where i: Observed organization and t: Time period
$LARI_{i,t}$: Leverage Assets Ratio Index: $LAR_{i,t}$ – (Minimum of all LAR values across all organizations and periods) / (Maximum of all LAR values across all organizations and periods – Minimum of all LAR values across all organizations and periods)
$CIRI_{i,t}$: Capital Inadequacy Ratio Index: $CIR_{i,t}$ – (Minimum of all CIR values across all organizations and periods) / (Maximum of all CIR values across all organizations and periods – Minimum of all CIR values across all organizations and periods)
$AIRI_{i,t}$: Asset Illiquidity Ratio Index: $AIR_{i,t}$ – (Minimum of all AIR values across all organizations and periods) / (Maximum of all AIR values across all organizations and periods – Minimum of all AIR values across all organizations and periods)
$MFRI_{i,t}$: Mobile Funding Ratio Index: $MFR_{i,t}$ – (Minimum of all MFR values across all organizations and periods) / (Maximum of all MFR values across all organizations and periods – Minimum of all MFR values across all organizations and periods)

CMRI is distinct from the risk appetite indices in the financial literature in several ways. In spirit, it is closest to *Global Risk Aversion Index* (GRAI), which points to "a correlation with a negative sign between price changes of the different assets and

[370] International Finance Corporation, 372.

their volatility."[371] GRAI is designed to be applicable to a number of markets, particularly currency and stock markets. Diversity of asset classes it fits gives it a more general character than CMRI, which blends risk indicators that exist in balance sheets of financial organizations only. Other composite indicators such as the *Westpac Risk Appetite Index* (WP), *UBS Investor Sentiment Index* (UBS), *JP Morgan Liquidity, Credit and Volatility Index* (LCVI), and *Merrill Lynch Financial Stress Index* (ML) include variables from fixed-income, equity, currency and commodities markets,[372] and do not focus solely on financial sector institutions as the CMRI does. "Since these measures combine many different types of risk (liquidity, credit, and market risks), the[ir] subcomponents do not always move together," and their scope ends up defeating the purpose behind "combining the components, [which] is to capture the overall risk appetite."[373] Dresdner Kleinwort's *Aggregate Risk Perception Index* (ARPI), which shows the "weighted average of seven indexes of perceived risks: foreign exchange, equity, credit, commodity, liquidity, emerging market and yield;"[374] and Lehman Brothers' *Market Risk Sentiment Index* (MARS), which is the "two-day moving average of the aggregate index [that combines] market volatility (one-year FX implied volatility and equity implied volatility), EM event risk (EM CDS spreads and EM equities), market liquidity (G3 swap spread), and risk appetite ratios (equity to bond returns, gold price to gold equity returns, and US equity P/E ratio)"[375] are vulnerable to the same problem of over-comprehensiveness.

CMRI also differs from other indices such as the *State Street Investor Confidence Index* (ICI), *Tarashev-Tsatsaronis-Karampatos Risk Appettite Index* (BIS),

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[371] Virginie Coudert and Mathieu Gex, "Can risk aversion indicators anticipate financial crises?" *Banque de France Financial Stability Review* 9 (2006): 85.
[372] *JP Morgan Liquidity, Credit and Volatility Index* (LCVI) also includes the GRAI mentioned above.
[373] Bank of Canada, *A Brief Survey of Risk-Appetite Indexes*, by Mark Illing and Meyer Aaron, Financial Systems Review (Ottowa: Bank of Canada, 2005), 38.
[374] FX Week, "Dresdner enhances risk appetite tool," last modified April 7, 2008, http://www.fxweek.com/fx-week/news/1544307/dresdner-enhances-risk-appetite-tool.
[375] Brenda González-Hermosillo. "Investors' Risk Appetite and Global Financial Market Conditions" IMF Working Paper No. WP/08/85, 2008. http://www.imf.org/external/pubs/ft/wp/2008/wp0885.pdf, (accessed April 2014).

Goldman Sachs Risk Aversion Index (GS), *Credit Suisse-First Boston Risk Appettite Index* (CSFB), *Gai and Vause Risk Appettite Index* (BE) in two fundemantal ways: it does not cater to the needs and priorities of particular organizations such as the State Street Corporation, Bank of International Settlements, Goldman Sachs, Credit Suisse-First Boston, and the Bank of England, which have developed these indices for their corresponding missions, respectively. Secondly, CMRI is an empirical index that follows a different approach from these theoretical indices, which are constructed against theoretical backgrounds. As the Dutch consulting cooperative KPMG notes, "Thinking about risk appetite is often unclear, definitions are vague and contradictory, and the gap between theory and practice is wide."[376] CMRI's sector-specific, performance-based and non-overinclusive design promises to provide focused and reliable information to market participants in finance –primarily banking consumers, policymakers, and financial institutions.

CMRI has a number of limitations. Firstly, it is a preliminary indicator of balance sheet risk that does not distinguish *good risk* from *bad risk*.[377] Cooperatives are organizations that exist in capitalist system, which relies on risk as a necessary element of its functioning. Irrespective of the role paid to government (regulatory vs. participatory, minimal vs. significant, etc.) or the way various economic actors relate to one another (unions vs. employers, regulators vs. businesses, workers vs. entrepreneurs, etc.), all forms of capitalism (neoliberal, social democratic, state capitalist, or any other form) include economic actors who control capital to make investments towards maximizing returns. As Illing and Aaron point out, "a low appetite for risk translates into a higher cost of capital, potentially limiting business investment, while a high appetite for risk can produce booms in credit and asset prices, sowing the seeds of

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[376] KMPG, "Understanding and Articulating Risk Appetite," last modified June 2008, https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/documents/Risk-appetite-O-200806.pdf.
[377] Koray Kalafatcılar and Gürsu Keleş, "Risk İştahı Endeksleri ve İfade Ettikleri," *Ekonomi Notları* (2011): 9.

eventual recessions and stress on the financial system."[378] "How much risk does an organization need to take on in order to attain appropriate and sought-after returns […] can be exceedingly difficult [to answer]."[379] The threshold where risk level began to jeopardize an organization's or economy's functioning is based too heavily on contexts to be determined accurately. Accordingly, any literature written with a language of capitalism (such as the present work) has to make use of the term *risk* in a non-judgmental fashion. It is essential to interpret the findings of this chapter and any other that may use CMRI in the future with full awareness of the fact that CMRI is a measurement of risk when risk is thought as *any* (but not necessarily, *excessive*) delegation of control. This conception of risk overlaps with the common (negative) connotation of the word only when CMRI figures are relatively high in an observed data set.

Secondly, CMRI is not a definitive quantitative measure that is perfectly comparable across data sets. It shows outcomes of an indexing procedure, which by definition, refers to assessments of observed phenomena relative to others within the same set of phenomena. It is an attempt to quantify a complicated and abstract concept like *managerial risk appetite* as policy-relevantly as possible –not an absolute gauge that shows perfectly objective evaluations. A particular CMRI value would not necessarily refer to the same level of real risk in different analytical sets with different actors, because different datasets would include different empirical values, from which CMRI values are determined.[380] For example, if all banks in Sweden are significantly more risk-averse than banks in Singapore, then a Swedish bank with a CMRI score of 0.8 would have a much less risky portfolio than its Singaporean counterpart with the same

[378] Illing and Aaron, 37.
[379] KMPG, "Understanding and Articulating Risk Appetite," last modified June 2008, https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/documents/Risk-appetite-O-200806.pdf.
[380] The issue of international incomparability can be mitigated by national ratifications of international laws that mandate certain intervals for risk indicators, which narrows down the spread between maximum and minimum values in CMRI procedure.

score. Therefore, international comparisons based on CMRI (or any other index) would be made only by analyzing relative position of each observed unit against *all* units in all countries without a national stratification –a Swedish bank compared against all banks in all observed countries rather than banks in Sweden only. This approach would help analysts avoid the “illusion of precision […] efforts to quantify risk appetite can sometimes produce.”[381]

2.5.2 Econometric Model

There are 28 domestic commercial banks[382] and 11 domestically chartered credit unions in Canadian financial system. Of these organizations, this analysis focuses on the five largest commercial banks and five largest credit unions as they control a vast majority of assets in their respective subsectors,[383] and their asset total collectively constitutes 91% of all assets in the sector. Assets controlled by the five banks ($3.2T) are 10 times the total assets held by the other 23 domestic banks combined ($0.32T), and assets controlled by the five largest credit unions make 98% of total assets in all 11 of the domestically chartered credit unions in Canada ($0.305T).[384] Largest banks and credit unions make a workable sample also due to better data integrity as they are the most professionally-managed and transparent organizations in Canadian finance.

CMRI figures for financial institutions allow investigation of managerial risk appetite with respect to various factors that influence it. This study takes CMRI figures of financial institutions as the dependent variable, and computes their values out of the

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[381] KMPG.
[382] *Schedule-I banks*, which are domestic, deposit-accepting institutions owned solely by Canadian entities and individuals.
[383] In descending order of their assets in Canadian dollars at the end of 2012 Q4, these organizations are Royal Bank of Canada/RBC ($825B), Toronto Dominion Bank/TD ($811B), Bank of Nova Scotia/SCOT ($668B), Bank of Montreal/BMO ($525) and Canadian Imperial Bank of Commerce/CIBC ($393B) for commercial banks; and Dejardins Group/DG ($201B), Vancity/VCU ($17B), Coast Capital Savings/CCS ($14B), Servus Credit Union/SCU ($12B) and Meridian Credit Union/MCU ($8) for credit unions.
[384] Author’s calculations based on sectoral totals from OSFI (Office of the Superintendent of Financial Institutions), and balance-sheet data from the ten observed institutions.

quarterly balance sheet data provided by the Office of the Superintendent of Financial Institutions –an independent government agency in Canada. In addition to the CU dummy variable to identify the affect of organizational type on risk appetite, the model also includes growth rates of quarterly real GDP (GGDP) and M3 money supply (GM3) as macroeconomic, financial sector share performance (GTSX) as sectoral, and profitability of observed organizations (GPROF) as organizational factors that affect CMRI outcomes as independent variables. The linearly formed model is as follows.

$$CMRI_{i,t} = \beta_0 + \beta_1\, GGDP_t + \beta_2\, GM3_t + \beta_3\, GTSX_{t-1} + \beta_4\, GPROF_{i,t-1} + CUDummy_i + u_{i,t}$$

where i: organizations
t: time periods (quarter)

Quarterly growth rates of real GDP shows the rate of increase in total output at the end of the observed quarter from the end of the previous one.[385] Output growth has a mixed impact on risk appetite in financial institutions.[386] It can work up the risk appetite of financial executives by stimulating a sense of security as a result of fiscal elation.[387] As positive news surface in an economy, increased output translates into better

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[385] While most governments (especially those in Northern Europe and Eastern Asia) prefer the *YOY* (*year-on-year*) method, which shows the growth rate of the quarter output from the same quarter in the previous year; this dissertation uses the *QOQ* (*quarter-on-quarter*) method for two reasons. Firstly, it is the method that Canadian government primarily uses in its official announcements of economic activity, and subsequently, Canadian financial institutions would refer the information it provides in their administrative decisions such as determining their organizational risk tolerance (Reference: Neo Poh Cheem, "Statistics Singapore Newsletter," *Singapore Department of Statistics*, March 2003, http://www.singstat.gov.sg/Publications/publications_and_papers/national_accounts/ssnmar03-pg7-10.pdf). Secondly, QOQ method reflects on the more immediate reality and climate in the economy, which makes it better suited to analyses of financial sector that is argued to embrace short-termism (Reference: Alison Atherton, James Lewis and Roel Plant, "Causes of Short-Termism in the Finance Sector," Discussion Paper (University of Technology Sydney Institute for Sustainable Futures, 2007), http://cfsites1.uts.edu.au/find/isf/publications/atherton2007causesofshorttermism.pdf (accessed February 24, 2014).

[386] Da-Bai Shen and Kuang-Hua Hu, "Bank Risk Appetite Measurement and the Relationship with Macroeconomic Factors: Case of Taiwan's Banks," *International Journal of Information Systems for Logistics and Management* 3, no. 1 (2007): 32.

[387] Herb Goldberg and Robert T. Lewis, *Money Madness: The Psychology of Saving, Spending, Loving, and Hating Money* (Washington, DC: Wellness Institute, 2000): 233.

economic prospects and higher demand for leveraging. While expansion of business volume is an institutional goal for both banks and credit unions, its capacity to motivate executives for further risk-taking would be higher with bank executives than credit union executives given that profit maximization is the institutional purpose of commercial banks, and executive compensation is several times higher in commercial banks that in credit unions (which creates higher opportunity costs of risk aversion for bank executives).[388]

On the other side, growth in real GDP can also curb financial institutions' risk appetite as the relationship between GDP growth and bank lending is bidirectional. Output growth accelerates financial institutions' lending appetite (demand-following hypothesis) as well as being determined by it (supply-leading hypothesis).[389] When financial institutions link growth performance of the economy to increased consumption fueled by excessive borrowing (supply-leading view outweighs the demand-following one), then their perception of credit risk could increase high enough to discourage them from further lending. Consequently, risk appetite diminishes in the financial sector following a period of GDP growth believed to have been driven by excessive consumption. Similarly, GDP growth and banks' risk appetite can follow different directions if and when non-performing loans reach significant levels in financial institutions' loan portfolios. GDP recovers from exogenous shocks in the medium-run (3-4 year) whereas cash flow challenges in banks' loan portfolios persist longer.[390] This situation translates into reduced risk tolerance among financial institutions even as the output rises back to equilibrium. Accordingly, we expect no sign from the GGDP

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[388] Juan Sebastián Amador, José E. Gómez-González, and Andrés Murcia Pabón, "Loan growth and bank risk: new evidence," *Financial Markets and Portfolio Management* 27, no.4 (2013): 365-79.
[389] Tuck Cheong Tang, "An Examination of the Causal Relationship between Bank Lending and Economic Growth: Evidence from ASEAN," *Savings and Development* 29, no.3 (2005): 313.
[390] Moinescu, Bogdan Gabriel; and Adrian Codirlasu. "Lending, economic growth and nonperforming loans: empirical evidences from the new EU member states" PN-II-ID-PCE-2011-3-1054 Working Paper, 2013. http://finsys.rau.ro/docs/wp-lending_economic_growth.pdf, (accessed April 16, 2015).

variable in the model due to the potential presence of these two opposite effects. GGDP data were retrieved from the OECD database.[391]

Money supply is "[…] a group of safe assets that households and businesses can use to make payments or to hold as short-term investments,"[392] and consists largely of the volume of currency in circulation and demand deposits. In the present analysis, the most comprehensive monetary aggregate used in Canada, M3, is used to show money supply.[393] Money supply can influence financial sector risk appetite both positively and negatively. Increased money supply applies upward pressure on the values of real and collateralized assets financial institutions control. Asset valuations compel financial institutions to perceive their portfolios' default risks and volatility to be lower, which drives them to resort to more volatile valuation techniques like VAR (Value-at-Risk),[394] and to compromise their lending discipline.[395] Furthermore, actual and expected increases in money supply by the Central Bank to improve contractionary conditions could encourage financial institutions to accept higher risks in an oligopolistic financial sector.[396] Because the failure of financial oligopolies would amplify in the larger economy, these companies could rely on the increased prospects that the government

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[391] OECD Quarterly growth rates of real GDP, change over previous quarter, http://stats.oecd.org/Index.aspx?QueryId=350.

[392] The U.S. Federal Reserve, "What's the money supply? Is it important?" http://www.federalreserve.gov/faqs/money_12845.htm.

[393] There are three major indicators that show levels of money supply: M1, which is considered to be a "narrow measure of money," refers to "currency outside banks plus all chequable deposits held at chartered banks, trust and mortgage loan companies, credit unions and caisses populaires (excluding deposits of these organizations); plus continuity adjustments (to "smooth" a time series when there are structural breaks)." M2 includes "Currency outside banks plus bank personal deposits, bank non-personal demand and notice deposits; less interbank deposits; plus continuity adjustments." Finally, M3 is the broadest indicator that includes all elements in M1 and M2 "plus bank non-personal term deposits and foreign-currency deposits of residents; less interbank deposits; plus continuity adjustments." Reference: Bank of Canada, "Canada's Money Supply," last modified October 2011, http://www.bankofcanada.ca/wp-content/uploads/2010/11/canada_money_supply.pdf.

[394] Ben Bernanke and Kenneth N. Kuttner, "What Explains the Stock Market's Reaction to Federal Reserve Policy?" *Journal of Finance* 60, no. 3 (2005): 1221-57.

[395] Martin E. Ruckes, "Bank Competition and Credit Standards", *Review of Financial Studies* 17, no. 4 (2004): 1073-102.

[396] *Causes of the Recent Financial and Economic Crisis*, Financial Crisis Inquiry Commission, September 2, 2010 (statement of Ben Bernanke, Chair, The U.S. Federal Reserve, Washington, DC).

would rescue them in the case of a failure.[397] On the other hand, increases in money supply affect output and employment positively in the short-run while having no effect on GDP and unemployment in the longer-run, which would be susceptible to inflation.[398] Accordingly, financial institutions could lower their risk appetite as a precautionary measure when they perceive the M3 level to precede inflation in the economy. Due to the possibility of two opposite effects on risk appetite, no sign is expected from the money supply variable. M3 data are obtained from the monetary aggregates database provided by the OECD.[399]

IShares S&P/TSX Capped Financials Index Fund (TSX from herein) is an indicator of sectoral performance that would influence risk-taking in the financial sector. It is a mutual fund "comprised of securities of Canadian financial sector issuers listed on the TSX, selected by S&P using its industrial classifications and guidelines for evaluating issuer capitalization, liquidity and fundamentals."[400] The fund provides an average value of the shares in financial institutions in Canada, and manages $847M worth of assets in its constituent companies with its 29.2M outstanding shares. Relationship between share prices and risk appetite follows a circle. Organizational risk appetites shape the extent to which businesses invest in the opportunities available to them, which in turn influence their share values.[401] Consecutively, increases in share values signify executives' effectiveness, and drives them to sustain or increase their risk appetite in order to respond to growth expectations of shareholders.[402] Compensated

[397] This moral hazard from bailouts can reasonably be expected to be more pronounced among commercial banks than not-for-profit credit unions.
[398] Milton Friedman, *Studies in the Quantity Theory of Money* (Chicago, IL: University of Chicago Press, 1956), 76.
[399] OECD Monetary aggregates –Broad Money (M3), http://stats.oecd.org/index.aspx?queryid=26670.
[400] "Overview of iShares CDN Financial Sector Index Fund (XFN-TSX)," Blackrock, accessed August 17, 2015, http://ca.ishares.com/product_info/fund_overview.do?ticker=XFN.
[401] Festus M. Epetimehin, "Impact of Risk Appetite on the Value of a Firm," *European Scientific Journal* 9, no. 22 (2013): 335.
[402] Rajan (2006), 515.

largely on the share performance without any reference to volatility;[403] executives who shift the costs of potential defaults to shareholders embrace risk in response to favorable performance in share values. TSX variable is included in the model as lagged by one period in order to count for the expectation that they influence risk appetite that is demonstrated in the next period, and to avoid the possible endogeneity problem. Thus, estimations are expected to provide a positive sign for this independent variable. Data for IShares S&P/TSX Capped Financials Index Fund were extracted from TD Waterhouse's database that tracks down fund values on a daily basis.[404]

(Lagged) profitability is a firm specific independent variable in the model. It shows the total amount of profits (or losses) an observed organization has made with respect to its assets in the quarter prior to a given one. Considering profitability (Profits/Assets) rather than total assets allows us to maneuver the scaling issue given that the five banks are significantly larger than the five credit unions in the observed data set. The underlying assumption in the choice of this variable is that executive boards in observed organizations would make their managerial decisions based partly on the profitability of their organizations in the last quarter. Profitability variable is lagged by one period (quarter) in order to reflect this reasoning, and also to avoid the possibility of endogeneity problem. Variations in lagged profitability derive from both time (quarters) and cross-section (organizations) dimensions. Profitability data were gathered from periodic financial statements (shareholder reports, balance sheets and/or annual reports) made available by the investor relations offices in observed financial institutions –online and/or upon request.

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[403] Federal Reserve Bank of New York, *Executive Compensation and Risk Taking*, by Patrick Bolton, Hamid Mehran, and Joel Shapiro, Staff Reports No. 456 (New York City, NY: Federal Reserve, 2010), 1.
[404] IShares data: TD Waterhouse (IShares S&P/TSX Capped Financials Index Fund). Pre-2001 data is the author's calculations from actual performance of the shares comprising the fund. https://research.tdwaterhouse.ca/research/public/ETFsProfile/Charts/ca/XFN.

Profitability is expected to influence executive risk appetite positively.[405] As an organic purpose of all business organizations in a capitalist economy; profitability improves corporate competitiveness, growth prospects, and financial capabilities – spelling higher achievements for businesses. It encourages their executives to welcome further risk-taking in order to sustain their positions and increase their incomes.[406] This cyclical relationship between profit-making and risk-taking in the financial sector is interrupted only when “profits bubbles” are corrected by financial meltdowns that supercede them.[407] Accordingly, a positive sign is expected from the profitability variable in the model.

Credit union CMRI scores are included in the model as the dummy variable, and are denoted as CU Dummy. Banks and credit unions are coded as 0 (zero) and 1 (one), respectively. Credit unions are considered to have lower CMRI values due to their institutional purpose and structure, which are build on the notion of social service as institutions of the 3rd sector. As financial cooperatives, credit unions are administered by executive boards, which are employed by member directors whose priorities are linked to the cooperative’s social purpose, judicious relationship to profits, and concern for sustainability. Expected sign on the credit union dummy variable is negative. Table 2 presents descriptive statistics of the variables in the model.

The table shows that quarterly GDP growth has fluctuated within a narrow band over the 52 quarters between 2000/Q1 and 2012/Q4. The difference between the fastest

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405 Including profitability variable in the econometric model, which includes share values as an independent variable, is not duplicative due to the impact of profitability on share values being miniscule in contemporary securities markets. While managerial decisions are formulated partly around profitability figures due to their role as a primary source of cash flows, profitability’s influence on share values is highly diluted by the impacts of expectations, trade momentum, monetary policy, and market rates of interest. Reference: Martin J. Gruber, “Determinants of Common Stock Prices,” *Journal of Finance* 21, no. 4 (1966): 747-8.

406 Lucian A. Bebchuk, and Holger Spamann, “Regulating bankers' pay” *Georgetown Law Journal* 98, no. 2 (2010): 247.

407 John Authers, “To reduce banks’ risks, profits have to shrink,” *Ft.com* (blog), February 24, 2012, http://www.ft.com/cms/s/0/db45542c-5eea-11e1-a087-00144feabdc0.html#axzz3YbgzDzEW.

and lowest growth performances in this 13 year time span was 5%. This figure speaks for the stability of growth in Canadian economy, which is ranked to be the best G7 economy for investing.[408] Slowest growth in the observed period was observed in the last quarter of 2003 when the output shrank by 1.2%. This was an element of the contraction in productive capacity as a result of factors such as the drastic (21.7%) appreciation of Canadian dollar in export-oriented Canadian economy, change in international oil prices in response to the occupation of Iraq, SARS outbreak and Hurricane Juan.[409]

Table 2. Descriptive statistics

Variable	Mean	Std. Dev.	Min	Max
$CMRI_{CB}$	0.956	0.018	0.716	0.986
$CMRI_{CU}$	0.857	0.155	0.238	0.933
GGDP	0.011	0.029	-0.021	0.141
GM3	0.017	0.008	-0.012	0.036
$GTSX_{Lagged}$	0.015	0.079	-0.269	0.256
$GPROF_{Lagged}$	0.005	0.009	-0.006	0.048

All observed institutions' risk appetites appear to have increased over time. From the first six years of the observed period (2000-2006) to the next (2007-2012), average CMRI value increased from 0.91 to 0.95 in banks, and from 0.76 to 0.86 in credit unions. Lowest risk level in the period was observed at Servus Credit Union (SCU) in the second quarter of 2001. While it occurred in a time period in which risk levels were generally lower for all institutions, SCU's CMRI value at 0.23 still marked a low point, which is nearly half of the value in the following quarter, and a fourth of the CMRI average in the entire period.

[408] Industry Canada, "Invest in Canadian industries," last modified September 27, 2013, http://www.ic.gc.ca/eic/site/icgc.nsf/eng/07055.html.
[409] Anonymous, "The economy: Year-end review," *Canadian Economic Observer* 17, no. 4 (2004).

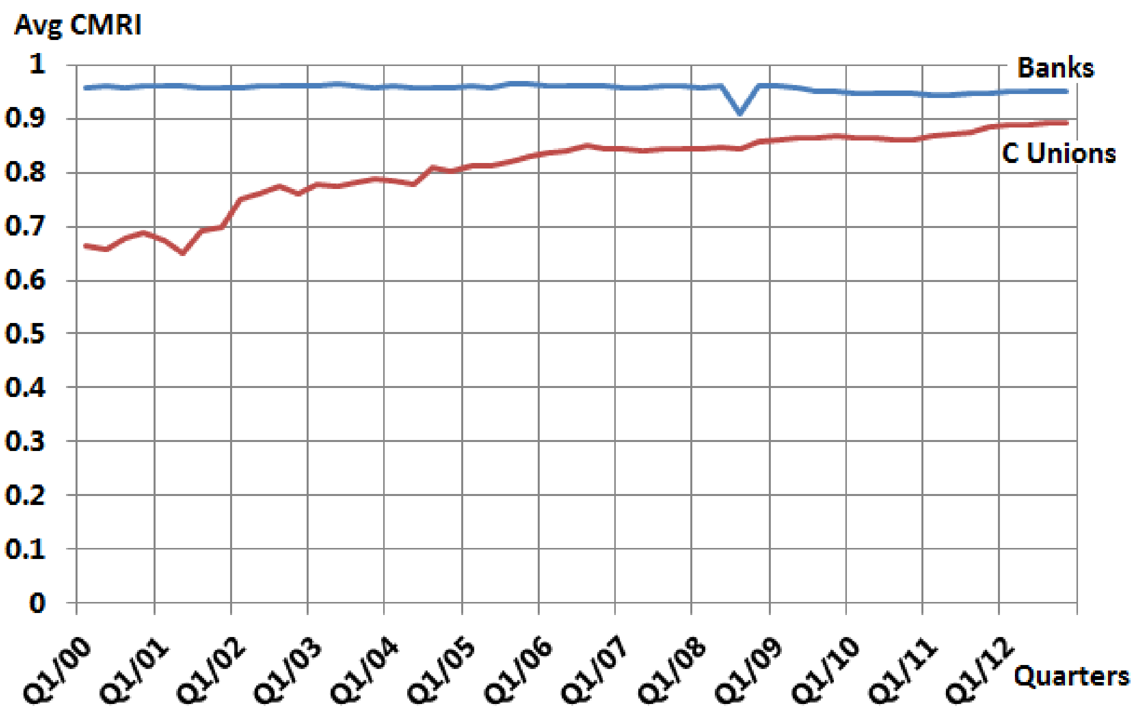
Profitability figures show that Meridian Credit Union registered the lowest performance in profitability growth. The credit union, which is the smallest institution observed, had its profitability fall by 0.6% between the third and the second quarters of 2004. This figure is about the same as the average profitability growth between quarters in all institutions (in absolute terms). On the other hand, Bank of Montreal's profitability growth (4.8%) from the 4th quarter of 2006 to the 1st quarter of 2007 became the fastest performance over the time period subject to the analysis.

Figure 1 illustrates the historical trajectory of CMRI figures across banks and credit unions between 2000 and 2012. Linear presentations of risk levels in commercial and cooperative banks illustrate that credit unions display a more conservative approach to corporate governance, even though this difference appears to be declining. Bank CMRIs show a significantly lower standard deviation than credit union CMRIs (1.8% vs. 15.5%). However, they also appear to be above credit unions' CMRI level in all quarters observed. Average credit union CMRI fluctuates between 0.65 and 0.9 whereas average bank CMRI floats within the 0.9-1 interval. Average (average) bank CMRI is 0.956, which is 18% higher than the average (average) credit union CMRI of 0.857. Commercial banks' higher risk absorbance provides empirical support for the argument that their higher risk appetite is an organizational feature relevant to their ontological purpose.

A sharp and short-lived fall appears to mark the transition of banks from Q3 to Q4 in 2008. Distribution of CMRI values across the five banks reveals that this fall was caused by a drop in risk appetite at Canadian Imperial Bank of Commerce (CIBC).[410] This fall (from a CMRI value of 0.95 down to 0.91 in a single quarter) represents an anomaly in the historical trajectory of CMRI values in this bank as well as the other four banks. Accordingly, it is likely to be explained with institutional factors internal to this organization, which are beyond the reach of this dissertation.

[410] Figure 1.

Figure 1. Historical trajectory of average quarterly CMRI values in observed commercial banks and credit unions (2000-2012)

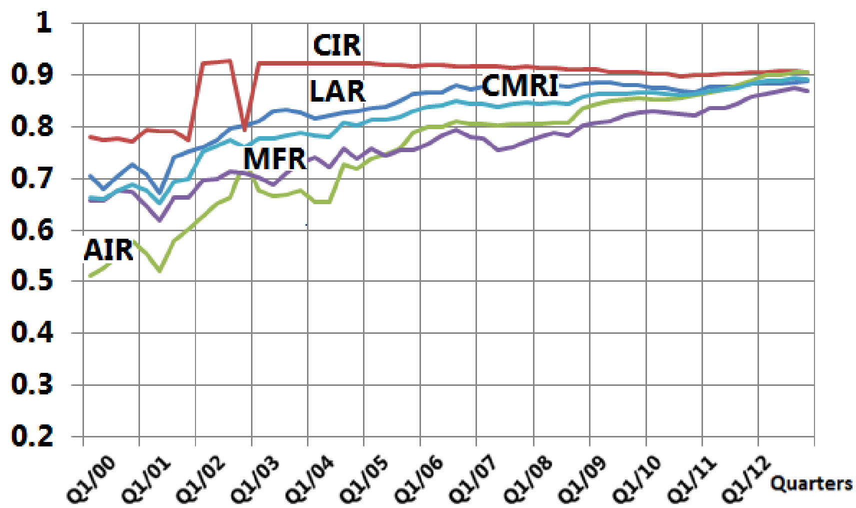


CMRI values among credit unions register a larger range of change than those of commercial banks. Average credit union CMRI score consistently increased from its level of 0.65 to 0.9 over the course of the twelve years following 2000. Two of the five credit unions observed (Meridian/MCU and Servus/SCU) consistently displayed lower levels of risk appetite than the other three credit unions.[411] As these organizations increased their risk tolerance over the first half of the observed period, credit union CMRIs converged with the commercial bank CMRIs towards the end of the period. The change of risk perception in these two organizations does not seem explainable by geographical factors (SCU is the only observed credit union that is located in the

[411] Figure 2.

province of Alberta, but MCU is located in British Columbia where the higher-CMRI Vancity/VCU operates), or by institutional size (lower CMRI SCU and MCU are both small institutions, but so is the higher CMRI VCU). This observation can also be linked to factors that are endogenous to the two credit unions.

Figure 2. Average CMRI elements for credit unions (2000-2012, quarterly)



When historical trajectories of credit union and commercial bank risk levels are examined closely, it becomes visible that the four balance sheet risk indicators that are blended into the CMRI move somewhat closely to one another in both sets of organizations. All four indicators generally moved upwardly with similar slopes. The development that appears to have contributed most to the convergence of credit union and bank CMRIs is the acceleration of asset illiquidity risk in credit unions (Figure 2). This may be an outcome of a trend among credit unions to increase the size of mortgage loans within their larger loan portfolio in response to the rapid growth in the real estate sector in the early 2000s.[412]

[412] *The Economist*, "The global housing boom: In come the waves," June 16, 2005.

2.5.3 Empirical Results

Panel data analysis is employed on the data that are bidimensional across time and individual organizations. This technique investigates the relationship amongst a number of specific entities with regularly repeated measurements over time. By allowing researchers to mitigate the heterogeneity problem and distinguish and observe individual/group effect and time effect by means of fixed and random effect analyses, panel analysis provides a more informative and diverse, and less collinear conclusion with a higher degree of freedom and efficiency.[413] Quarterly data between 2000 and 2012 constitutes a 10x52 long panel matrix that provides observations for risk and profitability in five commercial banks and five credit unions. It also includes growth, money supply and TSX index figures in Canadian economy.

Estimation results are presented in Table 3. The table presents the results of OLS estimations as a benchmark, and random effect estimations, which Hausman test favors over fixed effect estimations. F values and Wald statistic for the estimations indicate that the regression model performs well.

Table 3: Estimation results

Variable	OLS	Random effect
CU dummy	-0.13435[a]	-0.14335[b]
	(0.01068)	(0.05836)
GTSX (lag 1)	0.00507[a]	0.00543[a]
	(0.00117)	(0.00078)
GPROF (lag 1)	0.00002	0.0000002
	(0.00002)	(0.00001)
GGDP	-0.30304	-0.30285[b]

[413] Badi H. Baltagi, *Econometric Analysis of Panel Data* (Hoboken, NJ: Wiley, John & Sons, 2001), 6.

	(0.21138)	(0.13994)
GM3	-0.79245	-0.79707[b]
	0.61213	(0.40527)
F statistic	55.02[a]	
Wald		81.49[a]

Notes: Figures in parentheses are standard errors. a: significant at 1%, b: significant at 5%. Sample size in both estimations is 520.

Financial sector performance in the securities market (TSX) is found to have statistically significant influence on organizational risk appetite. Contemporary corporate culture that puts significant emphasis on stock compensations drives financial sector executives to consider their organizations' performance in customer service, labor practices and social responsibility secondary to its competence in maximizing share values. Securities-based compensation schemes are closely associated with higher propensities for business acquisitions, volatile instruments, and uneconomical capital accumulations.[414] Executive leaderships in financial institutions could tolerate suboptimal risk levels that can compromise their institutions' long-term sustainability goals, and this effect could be more pronounced in larger institutions (such as the five commercial banks analyzed) where monitoring and supervising incentive-based compensation schemes are more difficult.[415]

The roles of real output growth (GDP) and money supply growth (M3) appear to be statistically significant at 95% level of confidence in the random effect estimation. This outcome endorses an argument that improved economic prospects and the pool of available funds in the economy encourage risk-aversion among financial institutions. It points to a negative relationship between *good news* in the economy (rise in output and

[414] Sharma, Krishnan. "Financial sector compensation and excess risk-taking: a consideration of the issues and policy lessons" UN Department of Economic and Social Affairs Working Paper No. 115, 2012. http://www.un.org/esa/desa/papers/2012/wp115_2012.pdf, (accessed April 08, 2015).

[415] Securities and Exchange Commission, "Incentive-based Compensation Arrangements," https://www.sec.gov/rules/proposed/2011/34-64140.pdf.

money circulation) and risk appetite in the financial sector. This finding could be an outcome of the fact that the time frame, in which the ten leading financial institutions are observed, was a remarkably positive one for the Canadian financial sector. Marked by high loan demand and low default rates, favorable conditions in the sector could have diminished financial institutions' sensitivity to the growths of output and currency volume in the larger economy. As conditions of production and money circulation improved, financial institutions would have taken less risk due to an increasing perception of the prospects for a correction in the economy. OLS estimation, on the other hand, indicates that the influence of the *good news* factor is insignificant on the observed dependent variable.

Dummy variable for credit unions is found to be statistically significant. This finding is consistent with the expectation that cooperative-type organization in financial firms associate with a lower propensity for risk-taking. Credit unions' distinguishing features (not-for-profit purpose, stakeholder-controlled management, and local identity) appear to be associated with a more conservative management approach that frowns upon excessive delegation of control on assets and liabilities to external actors.

Impact of profitability (PROF) is found to be statistically insignificant. Rises in executive risk appetite as a result of recent favorable profitability performance may have been offset by a corresponding fall in risk tolerance due to satisfaction of profitability goals. Alternatively, this finding could be attributed to different dynamics that are at play in executive decision-making processes across different types of financial institutions. As previously explained, leaderships in commercial banks work to maximize their organizations' share value, and this goal is increasingly attained by forward-looking speculative trading more than backward-looking real accounting in modern finance. In contrast, performances of credit union leaderships are evaluated according to their organizations' recent performance in offering their stakeholders favorable loans, which treats profitability as a means rather than an end.

2.5.4 Findings

Panel data estimation results are consistent with the expectation that cooperative-type institutionalization is associated with lower risk propensity in the financial sector. Commercial form of financial intermediation appears to encourage risk-taking among financial sector executives who face risk-driven incentives for performance. Real growth in output and money supply appear to influence risk attitude among financial executives. Share values are found to be a factor behind organizational perception of risk in finance. Publicly trading, profit-maximizing financial institutions provide a contextual incentive to their leaderships to assume higher risks than their cooperative counterparts. This aspect of corporate culture marks the distinction of cooperative institutionalization that rewards service and prudence rather than value-maximization and rapaciousness. It confirms the hypothesis that credit unions are measurably less responsive to macroeconomic climate in terms of risk-taking.

Cooperative-type organization has its own distinct challenges, as well; however they are challenges that can be managed with proper governance in the organizational and the sectoral level. Improving the binding rules and regulations within and outside credit unions, executing external auditing, avoiding external credit, and improving incentives to attract savings are some of the ideas to improve effectiveness of the internal checks and balances within credit unions. As prudent governance complements the prudent spirit behind the cooperative form, credit unions will offer an increasingly advantageous and stable option in 21st Century banking.

Next chapter will present a survey of cooperative challenges in developed and developing country contexts in an effort to explore the ends to which contextual influences drive cooperative rationality. It lays out the common challenges faced by cooperatives in Turkey –the country with the highest number of cooperatives per capita, based on interviews with four of the most prominent cooperativists in this country. Identified challenges will then be contrasted against the issues experienced in a select group of countries in order to identify commonalities and their likely determinants along developmental lines. This analysis that sheds light on the relationship between cooperativism and contexts promises insights for policy agendas that aspire to revitalize cooperativism in countries at various developmental levels.

CHAPTER 3

COOPERATIVE RATIONALE IN CONTEXT: CONDITIONS AND PERFORMANCE

This essay provides a comparative examination of the issues facing cooperatives in Turkey and a select group of countries. It provides an account of cooperative challenges from a larger perspective than those adopted in national studies in order to identify commonalities in the nature of issues experienced. It seeks to contribute to the literature on cooperatives by examining the extent to which cooperative challenges can be addressed solely by policies that are relevant to the cooperative sector. Findings promise to assist policymakers with an outlook that extends beyond the immediate realities of cooperatives in their efforts to revive cooperativism. The essay shares the common theme in the two essays that are previously presented (the link between cooperative rationale and organizational stability), however it is detached from them in terms of its research question, methodology, focus and data.

3.1 Current State of Cooperativism

As socioeconomic enterprises established to consolidate individual and collective interests, cooperatives provide a unique context that incentivizes social responsibility in capitalism. As examined in the previous chapter, cooperatively-organized institutions that are owned and controlled by their stakeholders contribute to the broadest purpose of economics as a human activity: improving living conditions in terms of stability, prosperity, security and liberty. Nonetheless, despite their vast benefits, cooperatives are not among the common forms of businesses in contemporary time. While some of the largest and most successful businesses in the world's largest and most competitive economy are cooperatives (Minnesota-based Land O'Lakes, Illinois-based Ace Hardware, Massachusetts-based Ocean Spray, or California-based Sunkist to name a few), social economy enterprises such as cooperatives appear to exist as marginal organizations perceived as followers rather than challengers to commercial corporations.

A survey of 114 introductory economics textbooks in American Midwest and Northwest as far back as 1989 revealed that only 44% of general economics books, and *none* of the microeconomics and macroeconomics books mentioned cooperatives. 67% of those books published prior to 1949 covered cooperatives whereas the same figure was 48% for those published between 1950 and 1960, and a mere 22% for others published between 1970 and 1989.[416] A study on the presence of cooperatives in economics textbooks used in Helsinki University between 1995 and 2005 similarly found that the space dedicated to cooperatives has declined steadily over the course of the subject decade.[417]

Kalmi argues that the marginalization of cooperatives is an outcome of a paradigm shift in the 20th Century economics.[418] Increased economic roles governments adopted during the interwar years, and the following penetration of mathematical inquiry into economics theory in the second half of the century transformed economists from locally-oriented social scientists with a bottom-up focus to social engineers in pursuit of top-down solutions. This transformation has occurred at a time when economists' "[…] interest in privately provided solutions to societal problems waned" –rendering organizations such as cooperatives increasingly alienated in policymaking discourse.[419]

Alperovitz adds that examining policies rather than organizations have resulted in the discourse on *income disparity* to be subordinated to the discourse on *wealth disparity*. A "quietly growing reassessment" of economics in the present day now

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[416] Lori Lynch, Marilee Urban, and Robert Sommer, "De-emphasis on Cooperatives in Introductory Economics Textbooks," *Journal of Agricultural Cooperation* 89 (1989): 90.
[417] Panu Kalmi, "The disappearance of cooperatives from economics textbooks," *Cambridge Journal of Economics* 31 (2007): 625–47.
[418] Ibid.
[419] Ibid., p. 16-7.

focuses on the organizational core of the economy as a "[…] specific line of development stresses the possibility that workers might own their own companies, a straightforward idea that if extended and applied across the board implies a political-economic system quite different from both traditional socialism and corporate capitalism."[420] Establishments of study programs in *social enterprises* at leading universities like Harvard, Stanford and Yale; and growing interest in courses and programs in non-profit administration in the United States since the mid-1990s have been practical endorsements of the call for increased focus on social enterprises and worker-owned businesses.[421]

From a neoliberal perspective, cooperatives' apparent loss of significance is a predictable outcome of their waning relevance in a rapidly globalizing world.[422] In a highly connected world economy, in which international transportation of goods, services and factors become more cost-effective and convenient every day, businesses with a local perspective miss out on the opportunities against others that globalize their operations. Corporations that buy, sell or produce internationally take better advantage of *scale economy* –reducing unit costs and subsequently prices by spreading fixed costs over a larger production volume. They also gain the ability to take advantage of advantageous accounting techniques such as *transfer pricing*, which refers to minimizing tax burden by transferring goods, services and loanable funds between affiliates in various countries. Differences in corporate tax rates, tariff rates, quotas, and ownership restrictions allow global corporations to lower their taxable revenues by

[420] Gar Alperovitz, *America Beyond Capitalism: Reclaiming Our Wealth, Our Liberty and Our Democracy* (Hoboken, NJ: John Wiley & Sons, 2005), 20.
[421] Roseanne Mirabella, "University-Based Educational Programs in Nonprofit Management and Philanthropic Studies: A 10-Year Review and Projections of Future Trends," *Nonprofit and Voluntary Sector Quarterly* 36 (2007): 11s-27s.
[422] Gary M. Quinlivan, "Multinational Corporations: Myths and Facts," *Religion & Liberty* 10/6 (2000).

assigning non-market prices to the transferred commodities –giving these organizations formidable competitive power against competitors with a purely local outlook.[423]

Expanding potential sales market from domestic economy to a significantly larger world economy allows faster growth opportunities for globalizing businesses, and the prospects for transformation into monopolistic competitors. As Galbraith observed in the mid 20th Century, concentration of financial wealth and political power in the hands of a few conglomerates jeopardizes a society's democratic credentials and the validity of the argument that competition results in lower prices for higher quality goods and services. Galbraith acknowledged that most sectors of the U.S. economy were turning from a competitive marketplace into a new form of market, in which a large corporation has a near-monopoly market share whereas many small businesses compete for a miniscule share of the market. He called this crossbreed of monopoly and perfect competition "crypto-monopolistic market," and argued that it spelled the end of prices as an impersonal force that increases consumer surplus, and economic analysis a purely business matter irrelevant to political calculations.[424]

A negative outcome of monopolization that widens competitive disadvantages for cooperatives is the heterogeneous distribution of influence on policymaking. As multinational corporations register increasing amounts of revenues, and employ a larger workforce; three dynamics intensify to the expense of smaller local enterprises: monopolistic firms' financial ability to endorse political election campaigns and lobbying functions, their stakes in policy decisions made by political authorities, and their political power attached to the threat of unemployment due to outsourcing. This threat exemplifies the condition called *ultimatum game* in game theory –an interaction, in which one party coerces the other to behave in a particular way by threatening him

[423] Nilüfer Usmen, "How should MNCs use transfer prices to enhance value?" *Journal of International Business and Economics* 10, no. 1 (2010): 158.
[424] John Kenneth Galbraith, *American Capitalism: The Concept of Countervailing Power* (Boston, MA: Houghton Mifflin, 1952), 168.

with pulling the plug on the resources he needs. Cavanagh and Mander argue that this ultimatum game monopolies play with public officials allowed “global corporations [to] establish […] themselves as the dominant ruling institutions of the planet.”[425] They write, “Both (socialism and capitalism) centralized power of ownership in unaccountable institutions, the state in the case of socialism and the corporation in the case of capitalism. Both worked against the classic liberal economic ideal of self-organizing markets –markets in which communities organize themselves to respond to local needs within a framework of democratically determined rules.”[426]

Policymaking schemes that favor monopolization –such as tax exemptions, elimination of trade restrictions, or regressive corporate taxation- discriminate against cooperatives that are innegligible competition to corporations due to their willingness to offer lower prices thanks to their not-for-profit structure. Güven notes that “multinational corporations challenge cooperatives not only with economic competition, but also by forcing government mechanisms -legal establishments- to restrict cooperatives’ operations.”[427] Corporate tax and anti-trust laws are applied on cooperatives without considering their public purpose and not-for-profit character, and legislations appear increasingly responsive to corporate proposals to restrict cooperatives’ service to non-members, and to tax their surplus returns to members. Güven adds that whilst corporations have no restrictions on their financing, cooperatives are consistently exposed to limitations that hamper their ability to raise funds for investments: “Regulations and public education are typically designed to respond to the needs of commercial corporations, [and] no special advantages are provided for cooperatives except for those areas, in which private sector does not want to involve or public services do not work.”[428]

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[425] John Cavanagh and Jerry Mander, *Alternatives to Economic Globalization: A Better World is Possible* (San Francisco, CA: Berrett-Koehler Publishers, 2002): 15.
[426] Ibid., 9.
[427] Sami Güven, *Ekonomik Demokrasi ve Servetin Geniş Kitlelere Yayılmasında Kooperatifçilik Politikası* [Cooperativism Policy to Spread Economic Democracy and Prosperity] (Bursa, Turkey: Ezgi, 1997), 67.
[428] Ibid., 68.

Despite facing substantial handicaps in competition against commercial corporations, cooperative movement in the 21st Century includes remarkable success stories. Various manufacturing co-ops around the world take advantage of the opportunities globalization provides, and uses more efficient production factors from different countries to serve their consumers more competitively. Swedish detergent co-op Helios challenges powerful MNCs such as Proctor and Gamble, and Unilever with its high quality products sold at bargain prices. Oil and tobacco co-ops in Norway serve their customers well enough to disallow large MNCs to monopolize their markets. A Norwegian/Swedish light-bulb manufacturing co-op, Luma Electric managed to break the monopolistic power of globalized rivals in Scandinavia, and cut average prices by 37% in the market it serves. Basque industrial co-op Mondragón, and the Swiss retail giant Migros are some other successful cooperatives that have become enormous conglomerates with highly globalized presence.

Building on the international cooperative principle that calls for cooperation among co-ops, accomplishments of such worked-owned co-ops are a testimony that cooperatives are capable of sustaining their relevance for their communities if and when they adapt to the changes in the world economy.[429] Canadian sociologist Jack Craig concluded in his book entitled *Multinational Cooperatives: An Alternative for World Development* that cooperatives are not only capable of operating and competing internationally, but they are also more facilitative of international development due to their "service rationale that makes them more responsive to the needs and aspirations of developing nations."[430]

Next section examines the foundation of the marginalization of cooperativism in modern economies and economics by focusing on the same concept, which the previous

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[429] Ibid., 66-7.
[430] Jack Craig, *Multinational Co-operatives: An Alternative for World Development* (Saskatoon, Saskatchewan: Western Producer Prairie Books, 1976), 8.

chapter found to be a reason for cooperatives' stability: context. How do cooperatives, which create a positive context for social responsibility in corporate governance, respond to different contexts as organizations? If cooperatives' performance is closely intertwined with the socioeconomic contexts in the sectors they operate, potential they represent as a sectoral and macroeconomic stability factor emerges to be a function of these contexts. Accordingly, policymaking would not only endorse cooperativism, but also address the suboptimality of contexts that influence cooperativism in order to mitigate the possibility that large scale crises such as the Great Recession might occur in the years to come. In order to get a sense of the roles played by contexts in influencing cooperatives' performance, following sections examine the history and the current state of cooperativism *vis-à-vis* social, political and economic contexts in which it operates in Turkey.

3.2 Cooperativism in Turkey

Turkey's suitability as a unit of analysis for cooperativism studies derives from a unique juxtaposition it offers to global cooperativism: Although it is a country with a long history of cooperativism and a high number of cooperatives (10% of cooperatives in the world exist in Turkey, which has slightly more than a 100th of the world population), national significance of the cooperative movement remains intriguingly low in this country.[431] Foundation of Turkish cooperativism is traced back to 1863 when the first cooperative was established in Şehirköy, Ottoman Empire (Pirot, Serbia today). Turkish statesman Ahmet Şefik Mithat Paşa founded an agricultural credit cooperative under the name *Memleket Sandıkları* (Homeland Fund) in order to facilitate the use of farmers' savings to meet their financial needs. Effectively ending the usury-level interest rates that had been applied to loans to farmers, the cooperative paved the way to the establishment of other, more centrally regulated cooperatives called *Menafi Sandiklari*

[431] Turkish Ministry of Customs and Trade, "Yazıcı'nın 6 Temmuz Uluslararası Kooperatifler Günü Mesajı [Minister Yazıcı's Message for the 6th of July International Cooperatives Day]," last modified July 05, 2013, http://www.gtb.gov.tr/haberler/yazicinin-6-temmuz-uluslararasi-kooperatifler-gunu-mesaji.

(Benefits Fund), which later became *Ziraat Bankasi* (Agricultural Bank) –the oldest active Turkish bank today.

Cooperativist sentiment was sustained at the establishment of the modern-day Turkey in 1923. The founder and the first President of Turkish Republic, Mustafa Kemal Atatürk recognized cooperatives as an instrumental tool to accomplish socioeconomic development in the country that had a literacy rate of 7% and an economy that was almost entirely dependent on foreign countries at the time.[432] He actively promoted cooperativism in his speeches around the country, and urged scholars to study and research cooperativism. He signed *Kooperatif Şirketler Kanunu Tasarısı* [Resolution for a Law on Cooperative Businesses] into law in 1920 –three years before new Turkish parliament has opened its doors. In 1924, *İtibar-i Ziraat Birlikleri Kanunu* [The Law on Agricultural Credit Cooperatives] was legislated, and the first cooperative in modern Turkey was established in 1927 (*İtibar-i Zirai Birliği*, Association of Agricultural Credit). Atatürk included cooperatives in his party's (CHP) economic program, and became a founding member of *Ankara Memurin Erzak Kooperatifi* [Public Servants' Co-op Store of Ankara], Turkey's first consumer co-op (the type of cooperative that constitutes 92% of cooperatives in the world's leading economy today)[433]. He then went on to establish Turkey's first agricultural credit cooperative in 1936 under the name *Tekir Çiftliği Tarım Kredi Kooperatifi* (Tekir Farm Agricultural Credit Co-op), and shared his vision for cooperativism in various public addresses: "It is a certain necessity to establish cooperatives in a capital-scarce country like Turkey that has to protect its national economy against attacks by formidable European industry and capital, and foreign intermediaries.[434] Cooperative type organizations have always been welcomed

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[432] Ziya Gökalp Mülâyim, *Kooperatifçi Atatürk ve Kooperatifçilik* [Atatürk, the Cooperativist, and Cooperativism] (Ankara, Turkey: Yetkin, 2006).
[433] University of Wisconsin Center for Cooperatives, "Cooperatives in the U.S. Economy," http://reic.uwcc.wisc.edu/issues/.
[434] Mülâyim (2006), 24.

everywhere they operated. We find it possible to take advantage of cooperatives in teaching and production as well as in financing and marketing."[435]

Atatürk's embracement of cooperativism influenced Turkish policymaking for a better part of the 20th Century. In his book that was taught in Turkey's only school of economics at the time, Prof. Suphi Nuri İleri wrote "Cooperativism is the only economic regime that is organic and conducive to Kemalism, which is neither liberal nor communist."[436] *Ziraat Bank* [Agricultural Bank] has served its mission to coordinate and support *Tarım Kredi Birlikleri* [Agricultural Credit Cooperatives] for farmers' financing needs. In the 1950s, collaboration between beet producers' co-ops and *Türkiye Şeker Şirketi* [Turkish Sugar Company] allowed Turkish economy to be able to substitute sugar imports with domestically produced sugar. Over the following decade, *Köy Kalkınma Kooperatifleri* [Rural Development Co-ops] were established, and carried out the essential mission of educating rural population about modern farming techniques. These policies produced a number of success stories in agricultural cooperativism such as *Marmara Birlik* [Marmara Collective], which became the country's top exporter of table olives, and *Tariş Üzüm Birliği* [Tariş Grape Collective] –the second highest exporter of raisins in 2011. In the 1980s, KENT-KOOP housing project in Ankara became widely successful in constructing sustainable urban sprawl, and earned international recognition such as the "World Housing Year Award" by the British Government (1987) and *Légion d'honneur* [Legion of Honor] by the French Government (1993).[437] Today, Turkey has a number of cooperatives that have earned international reputation –such as Konya Şeker, which is set to build the world's largest meat-dairy

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[435] Türkiye Tarım Kredi Kooperatifleri Merkez Birliği [Central Union of Turkish Agricultural Credit Cooperatives], "Atatürk ve Tarım [Atatürk and Agriculture]," http://eski.tarimkredi.org.tr/goster.php?tablo=topic&id=1.

[436] Mülâyim (2006), 32.

[437] Mustafa Kara, "Konut İhtiyacının Karşılanmasında Konut Yapı Kooperatiflerinin Yeri [The Place of Housing Cooperatives in Meeting Housing Needs]," in *Konut Yapı Kooperatifçiliği* [*Housing Cooperativism*], ed. Nurcan Turan (Eskişehir, Turkey: Anadolu University Press, 2012), 70.

integrated facility as a part of its investments that reached $1 billion,[438] Tire Süt (dairy marketing), which is named to be "the best rural development model" by the United Nations in 2012,[439] and Huğlu whose hunting rifles are considered a status symbol around the world.[440]

Despite its 150-year history and international success stories, cooperativism failed to reach national significance in Turkey.[441] Today, only six of the 84,232 cooperatives in Turkey are listed among the largest 500 companies,[442] and a majority of cooperatives (65%) concentrate only in the construction sector.[443] Co-op membership rate remains at a mere 10% of the population[444] –well below the 50%-70% range in Ireland, Finland, Austria or Singapore.[445] Neither the only Turkish school of economics that is ranked within the top 200 in the world (Koç University Economics Department)[446] nor the top five business schools with the highest minimum scores for admission in Turkey (Boğaziçi, Koç, Bilkent, TOBB, and Galatasaray Universities)[447] offer a single course on cooperatives today.[448] SWOT analyses of Turkish cooperativism consistently unveil the fact that cooperatives suffer from a poor public image.[449]

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[438] Editor, "Huzurlarınızda Konya Şeker Efsanesinin Hikayesi." girisimhaber.com. http://www.girisimhaber.com/post/2013/01/25/Huzurlarinizda-Konya-Seker-Efsanesinin-Hikayesi.aspx (accessed August 14, 2014).

[439] Gencer Çetinkaya, "Birleşmiş Milletler Tire Süt'ü En İyi Model Seçti," *Ticaret*, News, May 19, 2012.

[440] Huğlu Hunting Firearms Cooperative, "About Us," http://www.huglu.com.tr/about-us.

[441] Nedret D. Okan and Cüneyt Okan, "An overview of cooperatives in Turkey," *Policy Studies on Rural Transition* 3 (2013): 36.

[442] Turkish Ministry of Customs and Trade, "İlk 500 Sanayi Kuruluşunda 6 Kooperatif [6 Cooperatives among the Top 500 Industrial Organizations]," last modified July 26, 2013, http://www.gtb.gov.tr/haberler/ilk-500-sanayi-kurulusunda-6-kooperatif.

[443] "Türkiye Kooperatifçilik Stratejisi ve Eylem Planı [Turkish Cooperativism Strategy and Action Plan]," *Resmi Gazete* [*Official Gazette*], October 17, 2012; 17-8.

[444] These are aggregate figures that are the sum total of member numbers in all cooperatives. Because a person can become a member to more than one cooperative, they do not refer to the number of people who are cooperative members.

[445] As, Özlem. Interview with Ayhan Çıkın. *Dünya Gıda*, October, 2012.

[446] Academic Ranking of World Universities, "ARWU Ranking of World Universities in Economics/Business-2013," http://www.shanghairanking.com/SubjectEcoBus2013.html.

[447] Derszamani.net, "İşletme Bölümü Taban Puanları [Business Department Rankings According to Minimum Admission Scores]," http://www.derszamani.net/isletme-bolumu-taban-puanlari.html.

[448] Koç University, "Course descriptions (Economics Department)," http://case.ku.edu.tr/econ/course/descriptions.

3.3 Interviews

This section will present an examination of the reasons behind cooperativism's demise in Turkey with an analysis of its interaction with the economic, political, legal and social contexts in this country. It aims to explore the extents to which cooperatives' performance could be attributed to the contexts in which they operate –versus their organizational purpose, which was explored in the previous chapter. To accomplish this, four of the prominent cooperativists in Turkey have been interviewed, and their thoughts and knowledge about the challenges cooperatives face in Turkey were compiled against a background of the current literature on international cooperativism. This approach is consistent with other cooperative studies that appreciate the practical knowledge veteran cooperativists offer to cooperative movements.[450] As Shaw notes, "Specific studies into corporate governance issues as they impact on co-operatives in the developing world are very few and this presents considerable difficulty in reaching any definitive conclusions. However, there are some clear starting points for an analysis of the key issues which can be derived from existing studies of the co-operative sector in general, several useful case studies, and discussions with co-operative leaders from the developing world."[451]

Boğaziçi University, "Course descriptions (Department of Management)," http://www.mgmt.boun.edu.tr/content/view/255/221/lang,en/.
Koç University, "Course descriptions (Department of Business Administration)," http://case.ku.edu.tr/bus/course/descriptions.
Bilkent University, "Curriculum (Faculty of Business Administration)," http://www.man.bilkent.edu.tr/index.php/page,8,curriculum.
TOBB ETU, "Undergraduate curriculum (Department of Business Administration)," http://etu.edu.tr/?q=en/node/398.
Galatasaray University, "Programme Details (Department of Business Administration)," http://ects.gsu.edu.tr/program/15/13.

[449] T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], Kooperatifçilik Genel Müdürlüğü [General Directorate of Cooperativism], *Türkiye Kooperatifçilik Stratejisi ve Eylem Planı* [Turkish Cooperativism Strategy and Action Plan] (Ankara, 2012), 25.

[450] Jos Bijman et al., *Support for Farmers' Cooperatives* (Wageningen, The Netherlands: Wageningen UR, 2012), 22.

[451] Linda Shaw, "Overview of Corporate Governance Issues for Co-operatives," Global Corporate Governance Forum discussion paper (February 8, 2007): 17.

Interviewed experts are, alphabetically, Erkan Rehber, Leyla Özcan, Murat Karayalçın, and Nurettin Parıltı. Erkan Rehber is a professor of agricultural economics who chaired Uludağ University's agricultural economics department between 1991 and 2008. He has taught and conducted research on cooperativism in Turkey, Norway, Germany, Israel and the U.S. between 1981 and 2001. He is the author of seven books in contract farming and agricultural management including *Kooperatifçilik* [*Cooperativism*] published in 2011.[452]

Leyla Özcan is the director general of *Türkiye Milli Kooperatifler Birliği* [*Turkish Cooperatives' Alliance*], a parent organization of 18 sectoral cooperative associations in Turkey. In 1978, Mrs. Özcan became the first female board member in Turkey's foundation-era institute of cooperativism, *Türk Kooperatifçilik Kurumu* [*Organization of Turkish Cooperativism*]. She has worked as a cooperative expert in the Central Union of Raiffeisen Cooperatives in Germany between 1966 and 1977, and as a special advisor to the Minister of Rural Works and Cooperatives in 1978. Mrs. Özcan cofounded *Türkiye Milli Kooperatifçilik Eğitim ve Araştırma Enstitüsü* [Education and Research Institute of Turkish Cooperativism] in 1978, directed the education and organization functions at Kent-Koop, an alliance of housing cooperatives in Ankara (1979). Between 2000 and 2007, she has worked as the editor-in-chief of *Türkiye Koop* [Co-op Turkey], a magazine published by *Türkiye Milli Kooperatifler Birliği* [Turkish Cooperatives' Alliance] where she currently administers.[453]

Murat Karayalçın is the former Vice Prime Minister of Turkey (1994-1995), and a former director general of Kent-Koop (1981-1991) –one of the most remarkable

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http://www.ifc.org/wps/wcm/connect/3aa7450048a7e6f1a93fef6060ad5911/GCGF_Discussion_Paper_Corporate_Governance_Issues_for_Cooperatives_070108.pdf?MOD=AJPERES

[452] Erkan Rehber, *Kooperatifçilik* [*Cooperativism*] (Bursa, Turkey: Ekin Publishing, 2011), back flap.

[453] Türkiye Milli Kooperatifler Birliği [Turkish Cooperatives' Alliance], "Özgeçmiş [Biography]," http://www.tmkb.org.tr/menu/Ozgecmis/17.

cooperative projects in modern Turkish history. Mr. Karayalçın has worked as an expert in *Devlet Planlama Teşkilatı* [Turkish State Planning Organization], deputy undersecretary of *Köy İşleri Bakanlığı* [Turkish Ministry of Rural Works] (1978-1979), director general of TÜRKKENT (*Türkiye Kent Kooperatifleri Merkez Birliği*, or Turkish Central Association of Urban Cooperatives, 1988-1993), and a board member of the ICA/International Co-operative Alliance (1994). His achievements in housing cooperativism were recognized by the British Royal Family ("World Housing Year Award," 1987), Nokta magazine ("Businessman of the Year," 1986), and the Government of France ("*Légion d'honneur* [Legion of Honor]," 1993). Mr. Karayalçın's later career in politics included responsibilities as the Mayor of Ankara (1989-1993), and the Vice Prime Minister, Minister, and Foreign Minister of Turkey (1994-1995).[454]

Nurettin Parıltı is a professor of business and marketing at Gazi University in Ankara, Turkey; and the president of *Türk Kooperatifçilik Kurumu* [Organization of Turkish Cooperativism] –a non-profit organization established to promote cooperativism in Turkey. Established in 1931 upon the directive by Mustafa Kemal Atatürk, *Türk Kooperatifçilik Cemiyeti/Kurumu* [Society/Organization of Turkish Cooperativism] was recognized in 1946 as a public purpose organization, and has been operating in non-profit status since 1983. Prof. Parıltı is the 19th President of the organization, which involves in consulting, research, education, publication, auditing, congress organization, legislating and archiving activities related to cooperatives in Turkey.[455]

Interviews with Prof. Rehber, Mrs. Özcan, Mr. Karayalçın and Prof. Parıltı were conducted on 2/8, 1/7, 2/21, and 1/28 in Ankara, Turkey; respectively. Each interview

[454] Türkiye Dışişleri Bakanlığı [Foreign Ministry of Turkey], "Sayın Murat Karayalçın'ın Özgeçmişi (Aralık 1994) [Mr. Murat Karayalçın's Biography (December 1994)]," http://www.mfa.gov.tr/sayin-murat-karayalcin_in-ozgecmisi-_aralik-1994_.tr.mfa.
[455] Türk Kooperatifçilik Kurumu [Organization of Turkish Cooperativism], "Activities," http://www.koopkur.org.tr/activities.htm.

took between 1.5 and 2 hours, and interviewees were invited to share their opinions on the eight general discussion points identified below:

1. Turkish cooperativism is not as vibrant as what would be expected in a country like Turkey that is home to 10% of cooperatives in the world. What are the predicaments that result in this outcome?

2. In countries such as Canada, United States and England where cooperatives struggled to find financing on favorable terms due to their not-for-profit structure, cooperatives' banks have been established to provide capital to cooperatives on favorable terms. How can we explain that there is no such bank in Turkey with 84,000 cooperatives that are challenged by the same condition?

3. It is well-established that maintaining collective spirit among members is a vital requirement of success in cooperatives. In your experience, how much emphasis would you say cooperatives in Turkey typically give to collectivity-boosting activities such as continuing education, team-building socials, or community service projects?

4. Are democratic organizations like cooperatives that give equal voting power and responsibility to their members compatible with the social fabric of Turkish society, which is conditioned by its Ottoman heritage to submit to authority?

5. A common characteristic among the successful cooperatives in Turkey is that they are led by charismatic and politically-connected leaders. What competitive advantages can those cooperatives that do not have such leaders create for themselves in order to succeed in an increasingly competitive Turkish economy?

6. If cooperatives represent valuable potential for socioeconomic development, but competent-yet-authoritarian leadership is a requirement for their success in developing

democracies, would you agree that an essential role governments can play in such contexts is effective auditing to disallow misappropriation of funds by cooperative leaderships?

7. Which cultural public policies can be adopted to promote cooperativism in an age, common spirit of which is argued to be nihilism, materialism and selfishness?

8. In sectors such as higher education in Turkey or healthcare in France, governments only allow non-commercial (non-profit or not-for-profit) organizations to operate so that prices would be controlled and supply stability could be attained. Would you think that similar restrictions to commercial enterprises should be imposed in other sectors such as the strategically-important sectors of banking, energy, or food?

The experts' responses were composed in the discussion about Turkish cooperativism presented in the following section.

3.4 Responses

Experts commonly pointed out that the weakness of Turkish cooperativism today is a function of a number of failures in economic, political, legal and social contexts in the country. They have expressed general optimism in the resolution of these challenges, and painted a picture of a bright future for cooperativism both in Turkey and around the world. They noted issues that can be classified in four main categories.

3.4.1 Political Context

Murat Karayalçın pointed out that Turkish public lacks an appreciation of cooperativism, and this attitude results in a lack of political will to support cooperativism in Turkey.[456] "Conventional sources of public information such as the print media, TV and universities do not dedicate enough space to cooperatives, […and] political action seldom surpasses an impractical rhetoric." An action plan to promote cooperativism was furnished under the title *Kooperatifçilik Strateji Belgesi: 2010-2014* [Cooperativism Strategy Document: 2010-2014], however the progress with it has been so slow that it stretched across the terms of three commerce ministers, and its title had to be changed to *Türkiye Kooperatifçilik Stratejisi ve Eylem Planı: 2012-2016* [Turkish Cooperativism Strategy and Action Plan: 2012-2016] in 2012.[457] As the Ankara chief of *Dünya* [World] newspaper and *Türkiye Gazeteciler Cemiyeti* [Turkish Society of Journalists], Taylan Erten notes, lack of transparency in governance leads to "flashy, comprehensive documents to be prepared on desks, […but] because there is no information channel or context to inform relevant parties about what public administrators actually do about them, […] reality on the field becomes different, and futures of these action plans appear blurry."[458]

Prof. Rehber argued that the gap from political reluctance cannot be compensated sufficiently by private initiatives due to the authoritarian state tradition in Turkey. He noted "a common feature in countries where cooperativism has advanced is the bottom-up ascension of cooperativism. In countries like Turkey, on the other hand, cooperatives are structured from top down. A negative outcome of this approach was that when market economics that obstructed social organization of any kind was imposed in the 1980s, cooperatives were alienated all together instead of being converted into more autonomous entities. […] Consequently, cooperatives have become a favorite in industry more so than agriculture or any other social sector, not because of

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[456] Murat Karayalçın, interview by Bülent Temel, Mr. Karayalçın's private office, Ankara, February 21, 2014.
[457] Ali Ekber Yıldırım, "Kooperatifçilik Stratejisi ve Eylem Planı...," *Dünya*, Columnists, October 17, 2012.
[458] Kobiden, "Strateji Enflasyonu [Strategy Inflation]," last modified May 22, 2011, http://www.kobiden.com/strateji-enflasyonu-11283h.htm.

its benefits to Turkish society, but because of the advantages of not-for-profit structure to their founders."

A government action plan to revitalize cooperativism in Turkey acknowledges that "government's interventionist sentiment has always been felt alongside its supportive and advisory roles ever since cooperativism was institutionalized in Turkey. The use of public funds and subsequent governmental interferences have increased cooperatives' dependence to the state and positioned them as quasi-governmental organizations. Consequently, cooperative members' senses of ownership and collectivist thinking have been compromised. In a questionnaire conducted among agricultural co-op members in 2008, 34% of the respondents said that cooperatives should be government-owned enterprises."[459] The report notes that this mentality was a product of the fact that agricultural cooperatives have always been funded by the government, and the most common type of co-ops in Turkey (housing co-ops) are owned and financed by their members, but associated with mismanagement and corruption –creating a perception of self-governance as an exploitative idea.

The top-down approach to public administration manifests itself in financing –a challenge for a vast majority of co-ops in Turkey. It is a rather common occurrence that cooperatives cannot attract loans on favorable terms because of their not-for-profit status and smaller collateralizable assets. Commercial banks in pursuit of collecting loan interests as high and early as the market allows are typically inclined to perceive cooperatives as risky clients with questionable repayment ability. In many countries, particularly in North America and Northern Europe, cooperatives have gone on to establish their own banks in order to satisfy their financing needs. These banks, which themselves are generally established as cooperatives; carry a vital role in the vibrancy and sustainability of the cooperative movement. In the case of Turkey, however, reflexes

[459] T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], 25.

of an authoritarian state tradition appear to have created a culture in which “helping hands” of the government are often thought of as the starter for any initiative.

Prof. Rehber notes that absence of cooperative banks in Turkish financial sector is an outcome of this culture. “The closest thing that resembles cooperative banks in Turkey are *Tarım Kredi Kooperatifleri* [Agricultural Credit Co-ops], which are cooperatives established to provide loans to farmers, but are funded entirely by the government. They have done a good job in serving farmers around the country, but the fact that their funding is appropriated by the government, and that they do not accept deposits from their members makes them distinctly different institutions. Self-sustaining co-op banking has never been considered as an alternative to public banking.”

Prof. Rehber finds “the concept of a bank that would collect cooperative members’ savings, manage them on their behalf, and direct them for cooperative purposes important. Cooperatives’ banks operate 23% of all bank branches, provide banking services to 870 million customers, and constitute the second largest banking network globally.” There are 350 cooperatives’ banks in 125 countries in the world, and they control assets worth $5.58 trillion to provide services as diverse as operations management, legal and tax planning, marketing and technological support for their member co-ops.[460] While most cooperatives’ banks rely on government funds in various degrees (18.6% in Canada and 40% in India), all 156 of the cooperatives’ banks in the U.S. are self-sufficient organizations that generate their resources by bond sales (59%), member deposits (23%) and international transactions (18%).[461] Although cooperatives’ banking is a growing trend in finance around the world,[462] Turkey that is home to a tenth

[460] İlhan Küçükkaplan, “Kooperatif Bankacılığı ve Dünya Genelindeki Uygulamaları, [Cooperatives’ Banking and Practice around the World]” *SDU Journal of Social Sciences* 8, no. 3 (2003): 36.
[461] Ibid., 39-40.
[462] Ünal Örnek, “Dünyada Kooperatif Bankaları Büyüyor,” Milliyet.com.tr (blog), July 22, 2012, http://blog.milliyet.com.tr/-dunyada-kooperatif-bankalari-buyuyor/Blog/?BlogNo=371678.

of all co-ops in the world has no cooperatives' bank.[463] Rehber notes that in Turkey, *Ziraat Bankası* [Agricultural Bank] had operated as a public sponsor of agriculture since 1937, but it has lost this mission in the 1980s when it transformed into a commercial bank to serve the larger society.

Turkish Government's action plan on cooperativism recognizes proposals for a cooperatives' bank, but dismisses the idea without providing explanations for it: "Cooperative sector as well as some institutions such as *Sermaye Piyasası Kurulu* [Capital Markets Board of Turkey], *Devlet Planlama Teşkilatı* [State Organization for Development Planning], and *Türkiye Bankalar Birliği* [Banks' Association of Turkey] articulated their proposals for the establishment of a cooperatives' bank during the preparation of a national strategy plan. However, the idea appears to be unattainable within the current context in Turkey."[464] KOOPBANK (*Kıbrıs Türk Kooperatif Merkez Bankası*, or Turkish Cypriot Central Bank of Cooperatives) demonstrates the vast potential in cooperatives' banking. A cooperatives' bank established in 1959 to collect and distribute funds among cooperatives in K.K.T.C. (*Kuzey Kıbrıs Türk Cumhuriyeti*, or Turkish Republic of Northern Cyprus); KOOPBANK has grown to be the largest company and most profitable bank in the country, which serves 33% of the population in 19 branches.[465] Its capital adequacy ratio is 27.89% -a respectable figure in international banking norms, yet alone in an island country that has been under economic embargo for four decades.

3.4.2 Legal Context

[463] Metin K. Ercan and İlhan Küçükkaplan, "A Cooperative Bank Model that would be Established for the Development of Turkish Cooperative System and its Contribution to the Cooperative System," in *Globalization and Cooperatives*, ed. Mehmet Arslan (Ankara: Turkish Cooperative Association Publication, 2002), 38-50.
[464] T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], 30.
[465] Kıbrıs Türk Kooperatif Merkez Bankası [Turkish Cypriot Central Bank of Cooperatives], "Tarihçe [Short History]," http://www.koopbank.com/SPhERE/cPortal/koop/layouts/content.jsp?pOTmplt=cnt&pName=Hakkimizda%20%3E%20Tarihce.

Prof. Rehber explained cooperativism's insignificance with the failure of agricultural cooperativism, which is typically the field where cooperative movements emerge around the world.[466] Agriculture is a sector where peculiar conditions naturally require cooperation among economic actors. Agricultural productivity is an outcome of natural phenomena more so than market dynamics. Consumers' demand for food does not rise above a certain level in response to lower prices due to the fact that food consumption has limits, and suppliers cannot supply more than what they have planted last year even if market prices rise in the present time. Price inelasticities of demand and supply drive farmers to collaborate with each other in order to hedge against the instability inherent in the sector. Agricultural co-ops allow farmers to negotiate their output on better terms (purchase guarantees and higher prices), access seeds, fertilizers and machinery cost-effectively, and reach out larger consumer markets.

In Turkey, however, agricultural co-ops could not operate as successfully, and become an encouraging model for other sectors. Rehber noted that a primary reason for this outcome was the fact that

> "a much-needed reform package for land ownership and agri-business has not yet been legislated and implemented despite decades of public discussion. As agri-businesses remain too small and geographically dispersed, they could not access relevant technologies and machinery that would help them reach optimal levels of productivity. [… Consequently] agricultural co-ops lacked cooperative spirit and scale advantages, and they could not offer attractive prices to be able to compete in a world of free trade. Their exposure to cheaper competition from abroad proved to be fatal."

Prof. Rehber added that "a world order, in which speculation-based paper economy triumphs over the real economy, does not provide a context favorable to cooperatives." He presented a skeptical outlook on the notion of political support for the international cooperative movement. "Events like the United Nation's declaration of

[466] Erkan Rehber, interview by Bülent Temel, Ankara, February 8, 2014.

2012 as the International Year of Cooperatives are politically-motivated acts to reduce the tension [in the world economy]," he argued. "International organizations such as the UN, World Bank, IMF, GATT or WTO have consistently promoted an international order defined by paper economy and ruled by multinational corporations under the name of free trade, which exacerbated inequality and suffering around the world." National governments, most of which are subject to the policy priorities of these organizations [due to their patronage or membership with them] embrace policies that conform to the neoliberal transformation –and Turkey has been no exception.[467]

Tax privileges, which had helped sustain the cooperative movement, were reduced as exemption from corporate taxes as well as some other smaller advantages in value-added-taxation were lifted for consumer, transportation and some housing co-ops. Similarly, some enterprise co-ops, which are associations of individual commercial businesses were treated as cartels in several occasions and were exposed to lawsuits. These cases have relied on the Article-4 of the Law on the Protection of Competition (Law no. 4054), which prohibits impairment of competition by means of monopoly power. A narrow interpretation of this law that ignores the purpose and function of enterprise co-ops intimidates these organizations in their growth ambitions. Prof. Parıltı added that the legal system also poses challenges in starting and running co-ops in Turkey.[468] "It takes at least seven people to start a coop today," he noted, "whereas only three founders are deemed sufficient even in a developed country like Canada where the stakes are even higher." Mrs. Özcan reminded that three founding members are required to establish a co-op in Sweden, and argued that "lack of coordination of laws, and subsequently overwhelming formalities of starting co-ops hurt the cooperative movement [by turning off potential cooperativists to start co-ops]."[469]

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[467] Şevket Pamuk, "Editor's introduction: Turkey's experience with neoliberal policies and globalization since 1980," *New perspective on Turkey* 47 (2012): 5-10.
[468] Nurettin Parıltı, interview by Bülent Temel, *Türk Kooperatifçilik Kurumu* [Organization of Turkish Cooperativism], Ankara, January 28, 2014.
[469] Leyla Özcan, interview by Bülent Temel, *Türkiye Milli Kooperatifler Birliği* [Turkish Cooperatives' Alliance], Ankara, January 1, 2014.

Interviewed experts commonly pinpoint the presence of several government agencies in charge of cooperativism, and several laws that govern cooperatives as a problematic politico-legal context in Turkey. Today, cooperativism units in the Ministries of Customs and Trade; Food, Agriculture and Animal Husbandry; and Environment and Urban Planning regulate cooperativism in their respective fields, and Law on Cooperatives (Law no.1163), Law on Agricultural Credit Cooperatives and Associations (Law no.1581) and Law on Agricultural Marketing Cooperatives and Associations (Law no.4572) provide legal basis for their regulation. This spread creates a dilution of responsibility to execute a systemic policy on cooperativism in practice. Mrs. Özcan notes that "lack of coordination among the public agencies of cooperativism prevents each agency to do anything more than carrying out the bureaucratic duties such as processing start-up paperwork, or responding to complaints. This issue has been widely articulated to the policymakers since 1968 when a State Organization of Development Planning report that shed light on this problem was released."

Prof. Parıltı argues that a positive relationship exists between the quality of governance and coordination of laws and agencies. He informs that "Turkey is better in cooperativism legislations than some other countries like Egypt where there are 13 laws on cooperativism, but this is not to say that three laws work better than one unitary law." Mrs. Özcan adds that "for cooperativism to rise to prominence in Turkey, government's role in it has to be diminished, and cooperatives must be allowed to sustain themselves on their own. This would be important not only for its economic benefits, but also for improving the public image of cooperatives, which are often seen as communist organizations. […] Cooperatives' connotation with communism is an artifact of the Russian and Yugoslavian experiments with cooperativism in the 20th Century, and it could be corrected with an image of cooperatives that act as self-sufficient private enterprises."

A 2012 government report on the state of cooperativism in Turkey concurred: "In order to give the cooperative movement credibility and efficiency, improve its image in the minds of the public and co-op members, and serve it sufficiently and effectively; a public organization whose sole function is to take rapid and effective precautions necessary for the cooperative system to contribute our country's economic and social development as expected must be established."[470] Mr. Karayalçın noted "cooperatives' core value for local development stems from their flexibility. In our time, the notion of governance is a difference maker. When cooperatives are liberated from governmental controls, flexibility of their governance that is based on rotatability of member managers shows. Individuals' energies are the blood stream of cooperatives."

All interviewees endorsed the view that effective and efficient auditing is a key determinant of a flourishing cooperative movement. They criticize that auditing function is often handled non-professionally, which contributes to the public image of cooperatives as corrupt institutions. As Prof. Rehber put, "it is not uncommon for non-expert members to be appointed to auditor positions. Unaware of their duties and responsibilities mandated by laws, they typically do no more than reiterating reports drafted by the boards of directors. Similar mindset is seen among the members, as well. Members who do nothing beyond voting in annual meetings do not exercise their basic rights to request information from co-op managers about the state of their cooperatives. Annual audits by independent external auditing companies must be a legal requirement for cooperatives in Turkey just as it is for commercial businesses." Furthermore, the fact that national organizations of cooperatives are given responsibility in auditing of cooperatives in the country, but membership to these organizations is kept optional creates an awkward structure. Accumulation of auditing function in organizations that are established to further the interests of cooperatives in Turkey points to a conflict of interest that has to be rectified.

[470] "T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], 26.

3.4.3 Economic Context

Prof. Rehber recognized neoliberal policies implemented since the 1980s as the culprit behind the weakness of Turkish cooperativism:

> "As popularized with the World Trade Organization's GATT arrangement, common approach to economic policymaking in Turkey has been a mindset that embraces international arbitrage. Neoliberal mindset promotes the idea of unrestricted international trade so that goods, services and inputs can be purchased from the economies where they are cheaper, and sold in others where they are more expensive. This [dynamic] benefits both participants as the consumer and producer surpluses increase in the receiving countries due to lower costs of production and prices, and less developed regions of the world find chances to lift their life standard by trading with more prosperous countries. Take [South] Korea. It has grown from an impoverished nation to a rich industrial behemoth over the course of thirty years."

Rehber reminded that a descriptive feature of the free trade scheme is elimination of trade restrictions as a development strategy, and agricultural co-ops, which had been protected against foreign competition, have become some of the earliest victims of the free trade policy:

> "Because agriculture is a field that had conventionally relied on subsidies due to its strategic importance and unpredictability, it has become a sector that was heavily hurt from cuts in subsidies and other protections like quotas and tariffs. Accordingly, agriculture's share in GDP has fallen in most neoliberal countries including Turkey, and brought down the significance of agricultural cooperatives as a primary actor in it."

Rehber added that neoliberal transformation of the world economy challenged cooperative movements around the world further by creating favorable conditions for monopolization of large businesses. He noted "cooperatives are institutions of market economy that mitigate the consequences of the failures and malfunctions in this type of economy. For this reason, discussions of cooperatives' performance have to involve an inquisition of market economics. Is it possible to speak of a true market economy based on free competition anywhere in the world anymore?" Large corporations that are able to dominate economic and political decision-making procedures embody formidable advantages over smaller, less ambitious organizations like cooperatives that keep their focus on serving their local communities. While *localization*, i.e. the practice of buying locally in order to support the local economy, is a rapidly growing social movement to counter the negative impacts of globalization around the world,[471] local small businesses are indisputably threatened by the presence of large chain stores and businesses that penetrate into their communities.[472] As Krugman points out, the U.S. economy has been transforming from a self-serving industrial giant into a service-oriented localization economy in terms of the GDP, but a manufacturing-oriented globalization economy in terms of the GNP: "Although we talk a lot these days about globalization, about a world grown small, when you look at the economies of modern cities, what you see is a process of localization: A steadily rising share of the workforce producing services that are sold only within the same metropolitan area."[473] Large businesses' domination of smaller businesses is best exemplified by the impressive performance of Wal-Mart, which, in a matter of five decades, has grown from a small grocery store in rural Arkansas to the world's largest company that buys goods manufactured in China and sells them predominantly in the U.S. –crowding out smaller local businesses along the way.

Relative weakness of Turkish cooperativism is also explainable by the interaction between capitalism and cooperativism on the largest picture. Prof. Parıltı notes "When you look at the world nations in which the cooperative movement is strong, you see that it has grown to be strong as a reaction to the injustices and exploitation in capitalism. Because Turkey has a relatively short history with capitalism, the conditions that warrant cooperativism to rescue disadvantaged masses from vulgarity of the

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[471] Arturo Escobar, "Beyond the Third World: imperial globality, global coloniality and anti-globalization social movements," *Third World Quarterly* 25, no. 1 (2004): 207-230.
[472] Haltiwanger, John C.; Ron S. Jarmin, and C. J. Krizan. "Mom-and-Pop Meet Big-Box: Complements or Substitutes?" NBER Working Paper No. 15348, 2009. http://www.nber.org/papers/w15348.pdf?new_window=1, (accessed March 8, 2014).
[473] Paul Krugman, *Pop Internationalism* (Cambridge, MA: MIT Press, 1996), 21 as cited in Alperovitz, 126,

capitalist class have not emerged yet. We are rapidly getting there, which is why cooperativism will be so crucial in Turkey's future." A visual demonstration of the largest 300 co-ops in the world shows that a vast majority of the large co-ops are located in Northern Europe and North America –two regions with the oldest history of capitalism (Figure 3).

Figure 3. Geographical dispersion of the world's largest 300 co-ops[474]

Created also by other capitalism-relevant factors such as the presence of larger consumer markets, better institutions, or more developed awareness of the cooperative tradition, this reality endorses the view advanced by Prof. Parıltı.

3.4.4 Social Context

Interviewed cooperativists commonly expressed that cooperative sector's achievements are a direct function of public consciousness and concerned citizenry. "By definition, developing countries have less industrialized economies," said Parıltı, "and

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[474] Co-operative News, "View the top 300 co-operatives from around the world," last modified February 4, 2014, http://www.thenews.coop/49090/news/general/view-top-300-co-operatives-around-world/#.Ux3bXz-SySo.

educational attainments to meet the demands for an industrial workforce remain limited, accordingly." Mrs. Özcan added that "there are a lot of policies government can follow to increase the society's awareness and collectivity. Reforming education system away from memorization and teaching practical skills in addition to academic knowledge are among those. Children should be raised from an early age so their communal instincts develop as a part of their identity. Mass media should be acknowledged by the government as an information transmission mechanism, and be incentivized to broadcast socially responsible programs. […] When people trust each other more, they would cooperate with each other more. This is the bottom line." Prof. Rehber pointed out that government should also reverse the moral challenges Turkish society seems to face by policies to reverse urbanization. Public and private investments to rural areas should be subsidized, and neoliberal policies that effectively outsource domestic agriculture should be halted."

Despite the negative sentiment in the research subject for which the interviews are conducted (contextual suboptimalities that challenge cooperativism in Turkey), all four of the experts displayed a positive outlook for the future of Turkish cooperativism. In a rapidly globalizing world economy, opportunities for professionally-run cooperatives are larger than the challenges against them. Social and economic struggles associated with globalization bring the needs for cooperatives to surface while opportunities for international trade expand capabilities for them. Cooperativism will not just survive in the 21st Century Turkey –it will spread into new sectors of the economy.

Leyla Özcan pointed out that "Turkish public is not knowledgeable about cooperativism, and this condition causes a lack of appreciation for what it can do for the country. […] Turkey's education system should be reformed to install collective-mindedness in the minds of new generations, and cooperativism should be taught as a legitímate option for start-ups." She recommended "restarting and spreading organizations such as *Kooperatifçilik Araştırma ve Eğitim Merkezi* [Research and

Education Center for Cooperativism], which was established in 1970s, but closed by the government for ideological reasons in the politically-turbulent 1980s." As stand-alone public organizations or research centers within universities, such institutes would not only help established co-ops improve their effectiveness, but also endorse the idea of new start-ups to be established as co-ops, which would allow those people with business acumen but limited resources to utilize their potential. "Cooperative start-ups are a solution to the unemployment problem that threatens millions of young people around the world."

This point echoes that of the former U.S. President Bill Clinton who noted that "I have a remedy to youth unemployment. I went to Italy to see how cooperatives established by young people were doing. These cooperatives are natural in Italy, but not in the United States because people are used to working for themselves in the U.S. We need to change this. When I turned back from Italy, I had 67 co-ops be established in mining, healthcare and insurance in my home state. Today, young people are working in these co-ops for their common good rather than own interest. This is a remarkable situation that was unprecedented in the U.S."[475] Mrs. Özcan also recommended TÜİK/*Türkiye İstatistik Kurumu* (Turkish Organization of Statistics) to "keep track of cooperatives as a separate class of business than commercial companies so that cooperatives' true contribution to Turkish economy and society could be monitored, appreciated and managed. […] Anything not measured cannot be appreciated."

Prof. Parıltı mentioned that lower level of education in Turkish society deprives the country from "fate leaders" whom he describes as "the people who can make a difference for good. […] A national education philosophy that is based mostly on testing cannot produce necessary minds that have the vision and initiative to carry out meaningful change." He reminded that "one of the seven universal principles of cooperativism is continuous education to keep cooperative spirit alive inside co-ops.

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[475] Mülâyim (2006), 116.

Turkish co-op leaderships often ignore this principle, and do not carry out any education programs. Rare educations are implemented for the sole purpose of training members about how to do their individual jobs better, but I have not come across any educational session that emphasized the ways to work collectively as a union."

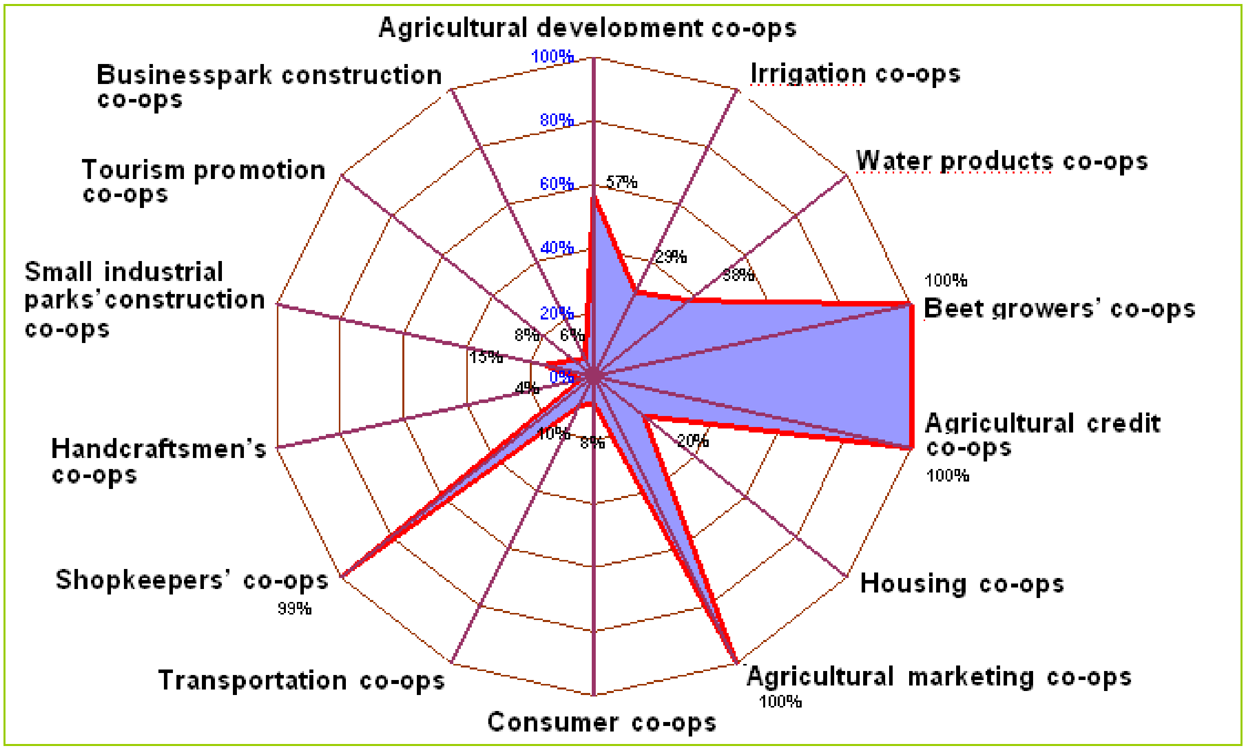
A 2008 survey by the Customs and Trade Ministry entitled *Kooperatifçilik Sektörü Anket Çalışması* [A Survey in the Cooperative Sector] revealed that "most co-op members and managers in Turkey have never taken part in any educational activity whatsoever."[476] Common disregard for the universal cooperative principle of continuous education is a product of the ideological marginalization of cooperativism at the governmental level, funding problems in umbrella organizations at the sectoral level, and a general lack of appreciation for education at the societal level. Bureacratic authorities conventionally overlooked the Law on Cooperatives (Law no. 1163), which kept ministerial cooperativism offices in charge of training co-op members, managers and auditors in Turkey. Poorly organized sectoral organizations often failed to raise enough funds to carry out periodic trainings of their members. As Figure 4 shows, cooperatives' participation to sectoral organizations is alarmingly low, which points to the need to review training responsibilities in Turkish cooperativism.

Individual co-ops typically lacked consciousness, coherence and professionalism needed to bring their members together for trainings to sustain the viability of their operations. Interviewed experts commonly agreed with the idea that more degree programs on cooperativism should be offered in Turkish universities, their scope should be expanded to fields other than agriculture, and target audience should include the general public as exemplified by *The Academy of Cooperatives* in Germany, or *The Cooperative College* in England. This view was consistent with the proposal for a

[476] "T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade], 27.

university of cooperativism discussed at a recent workshop on cooperative education co-organized in Ankara, Turkey by the ILO, ICA and TURKKOOP.[477]

Figure 4. Participation to higher organizations according to cooperative type[478]



Educational aspect builds on the literature that documents the close link between human capital and cooperatives' performance. A 2010 study by Chang et al. found that social capital and cooperatives' performance are mutually influential in the sense that "social capital is a crucial factor that affects future cooperation intention, and cooperative performance is a partial mediator between social capital and future cooperation intention."[479] Authors find that social capital supports productive capacity

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[477] Bülent Temel, "Türkiye Kooperatifler Üniversitesi [Cooperatives University of Turkey]" (presentation, ILO/ICA/TURKKOOP Workshop on Cooperatives Education, Ankara, Turkey, April 25, 2014).
[478] Ibid., 20.
[479] Shu Chun Chang, Chin Jung Tu, Ting-Jia Li, and Bi-Kun Tsai; "Social Capital, Cooperative Performance, and Future Cooperation Intention among Recreational Farm Area Owners in Taiwan," *Social Behavior and Personality* 38, no. 10 (2010): 1409-29.

and efficiency by reducing transaction costs, and increases flexibility of decision-making processes.[480] Parıltı stressed that "for cooperativism and its benefits to be appreciated, society in general and policymakers in particular have to comprehend their long-term benefits as organizations of stability. This is where most developing nations including Turkey fail. They typically have a short-term outlook, which makes them overlook the benefits in the long run. […] That's why cooperatives in developing countries cannot attract good managers. True professionals have vision, and they choose companies that pay them best, because they are in short supply."

Prof. Rehber agreed with the proposition that executive competence is a success factor in cooperatives, but disagrees that it is a condition specific to cooperatives. "Management class pursuing its own interests is definitely a problem in many cooperatives; however capitalist firms are not immune against that problem, either. People with questionable integrity and motivation can take on management roles, and the organization can suffer from corruption and nepotism in all kinds of businesses. […] Remember that fewer and fewer companies are distributing dividends nowadays. This means savings of the people of limited means have been funneled into speculators by means of the stock exchange market."

Akpınar identifies a number of failures in sociopolitical culture that slows down the progress towards a more transparent government in Turkey.[481] Among these failures are "excessive bureaucracy, lack of regulative impact analyses (DEAs), the culture of non-merit based promotions in higher levels, reluctance for fiscal transparency, lack of regulations to define the scope of *state secrets*, and the norm of *a priori* trust/mysticism

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[480] Yanjie Bian, "Social Capital of the Firm and its Impact on Performance: A Social Network Analysis," in *The Management of Enterprises in the People's Republic of China*, ed.s Anne Tsui and Chung Lau (Boston : Kluwer Academic Publishers, 2002), 275-97.

[481] Mahmut Akpınar, "Gün Işığında Yönetim Açısından Türk Kamu Yönetiminde Açıklık ve Şeffaflık Sorunu [Government in Day Light: The Question of Openness and Transparency in Turkish Public Administration]," *SDU Journal of Faculty of Economics and Administrative Sciences* 16, no. 2 (2011): 235-61.

that dominates public's perception of the government."[482] This observation is consistent with the findings of Geert Hofstede to whom Mrs. Özcan made a reference during her interview. A Dutch social psychologist who cataloged common behavioral traits of world nations, Hofstede found in Turkey a score of 66 for power distance, which "is defined as the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally."[483] He noted that Turkish society appears to be a "dependent [and] hierarchical [society, in which] superiors [are] often inaccessible and the ideal boss is a father figure. Power is centralized and managers rely on their bosses and on rules. Employees expect to be told what to do. Control is expected and attitude towards managers is formal. Communication is indirect and the information flow is selective. The same structure can be observed in the family unit, where the father is a kind of patriarch to whom others submit." Özcan agreed with the view that these findings are confirmed with the concept of *kul* [servant] in Ottoman sociopolitical culture, which refers to a perception of citizens as loyal servants of the state and the constituents of its supremacy.[484] "This mentality needs to change faster," she said, "because, as Michael Solomon wrote in his book *Conquering Consumerspace*, we are heading towards an era, in which supply will include unconventional bottom-up initiatives, and will be determined by demand. And both of those phenomena will be driven by the awareness and self-confidence of citizenry."

Prof. Rehber rejected the idea that democratic organizations like cooperatives that rely on empowering individuals versus higher authorities are fundamentally incompatible with the social foundation of Turkish society that embraces conformism. He made note of the concept of *imece*, which refers to the rural practice of mutual help

[482] Ibid., 251-4.
[483] The Hofstede Center, "What About Turkey?" http://geert-hofstede.com/turkey.html.
[484] Bülent Temel, "European Union and Turkey: Transformation of State-Society Relationship" in *Societal Peace and Ideal Citizenship for Turkey*, ed.s Rasim Sönmez and Pınar Enneli (Lanham, MD: Lexington Books, 2011), 207-26.

with work that cannot be handled alone: “Traditions of imece and mutual support have a long history in Turkey.” A peculiar socioeconomic institution called *ahilik* [akhism] was also born in the 13th Century and survived seven centuries. It was a guild based on the principles of “mutual help, solidarity, brotherhood, devotion, jobs for everyone, fair pay, honest production, fair prices, and members’ training.”[485] Established practically every corner of the Ottoman Empire, *ahi* units created mutual help funds called *orta sandığı* [common safe] or *esnaf sandığı* [shopkeepers’ safe], which provided resources for ahi members’ financing and social security needs. Yüksel identifies seven commonalities between *ahilik* [akhism] and cooperativism: “Free entry and exit, democratic governance (management by elected leaderships based on fairness and rules), education (allocation of a portion of surpluses into job trainings during days and spiritual trainings at nights), producer-consumer relations without middlemen, purpose being service to members rather than ambition for self-profits, upper (regional and national) organization, and accumulation of surplus in a common safe to be used for the members’ needs.”[486]

Prof. Rehber reminded that “Grand Vizier Mithat Paşa established *Memleket Sandıkları* [Homeland Safes, a primitive form of an agricultural credit coop] only 19 years after Rochdale Society of Equitable Pioneers started their co-op [the world’s first dividend-paying consumer coop] in England in 1844.[487] The model of agricultural marketing coops with packaging facilities was initiated in Turkey in 1936 –long before it was used in the U.S. as ‘new generation’ coops in the 1970s. The issues in Turkish cooperativism have more to do with the economic system and mindset than Turkish traditions and behavioral patterns.” The fact that cooperativism is strongest in advanced

[485] Necdet Bilgin and Şaban Tanıyıcı, “Türkiye’de Kooperatif ve Devlet İlişkilerinin Tarihi Gelişimi,” *KMÜ İİBF Dergisi* 10, no. 15 (2008): 138.
[486] Yüksel, S. *Kooperatifçiliğin Türkiye’deki Tarihi Gelişimi, Önemi ve Sayısal Veriler Işığında Günümüzdeki Durumu* [History of Cooperativism in Turkey, Its Significance and Current State Based on Quantitative Data] (Ankara, Turkey: Türk Kooperatifçilik Yayınları [Turkish Cooperativism Publications], 2005), 193.
[487] Although Rochdale initiative was the first known co-op that distributed surplus back to its members, cooperative history is believed to trace back to The Shore Borders Society, which was a workers’ co-op established in Scotland in the late 15th Century. Source: The Shore Borders Society, “About Us,” http://www.shoreporters.com/shore-porters-history.php, (accessed March 9, 2014).

democracies in North America and Scandinavia demonstrates that functional democratic institutions provide favorable contexts for cooperativism."

Mrs. Özcan contended that the spirit of cooperativism is compatible with the "original Turkish culture, but incompatible with its contemporary version. Emergence of free market capitalism over the last few decades made it very difficult for rural people to make the end's meet, and migration to cities followed. Urbanization compels people to lose their native cultures. In a country like Turkey where 70% of people live in urban areas, original cultures' acceptance of cooperativist mentality becomes irrelevant." She considered urbanization responsible from the erosion of social values in the society, and consequently a decline in civic virtues.

A great obstacle in front of Turkish cooperativism is the *trust deficit*, from which Turkish society suffers.[488] The current state of social relations in Turkey appears to include a level of mutual trust that is below a minimum level mutual organizations like cooperatives need in order to function successfully. A field research in 2002 showed that only 5% of people in Turkey believed that "people are mostly trustworthy," and this figure put Turkey on the 45th place among 47 countries surveyed.[489] Same ratio is found to be between 50% and 65% in Canada, Norway and Sweden –three of the countries with strongest cooperative movements.[490] Another study of agricultural marketing coops in the U.S. in the same year found that "trust among members, and trust between members and management are important predictors of group cohesion, which is a

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[488] Bülent Temel, "Candidacy versus Membership: Is Turkey the Greatest Beneficiary of the EU?" in *The Great Catalyst: European Union Project and Lessons from Greece and Turkey*, ed. Bülent Temel (Lanham, MD: Lexington Books, 2013), 375.
[489] Pippa Norris, "Making Democracies Work: Social Capital and Civic Engagement in 47 Societies," Midwest Political Science Association Conference, Chicago, 25-28 April 2002, 11.
[490] Asuman Altay, "Bir Kamu Malı Olarak Sosyal Sermaye ve Yoksulluk İlişkisi," *Ege Akademik Bakış* [Aegean Academic Review] 7, no. 1 (2007): 337–62.

measure of the strength of members' desires to remain in a group (co-op) and their commitment to it."[491]

Mrs. Özcan made note of two social practices in Turkey and Sweden to highlight the ethical gap between the two societies. She says "while we [Turkey] have *blank petition*, Swedes have *burnout* in their business culture." *Blank petition* is the practice of an employer having an employee sign a blank letter so the employer can fill it up with a legitimate reason if it wants to lay off the employee in the future. Albeit illegal, it is known to have been practiced in the private sector at times –particularly in the recruitment of lowly qualified workforce. *Burnout*, on the other hand, is a social security benefit offered in the welfare state of Sweden. It refers to the legal right for employees to document their exhaustion with work, and go on a paid leave (for 199 days on average)[492] to recover. Employers encourage those workers who feel exhausted to take advantage of the burn-out practice in order to improve their efficiency –rather than using it as a reason to confront or fire stressed out workers. Striking difference between the two practices underlines the enormous gap in common ethics and mutual trust in the two societies, which is utterly relevant to the difference in national significance of cooperativism in Turkey and Sweden.

A 2009 study on one of the world's most successful cooperatives, Mondragón, demonstrated the essential role social capital and trust play in cooperatives' performance. Lizarralde who defined *social capital* as "networks of strong, crosscutting personal relationships developed over time that provided the basis for trust, cooperation and collective action in such communities," found that "within and between firms, social capital reduces organizational dissolution rates, facilitates entrepreneurship and the formation of start-up companies, and strengthens supplier relations, regional production

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[491] Mark H. Hansen, J. L. Morrow, Jr., and Juan C. Batista; "The impact of trust on cooperative membership retention, performance and satisfaction: an exploratory study," *International Food and Agribusiness Management Review* 5 (2002): 41.
[492] "Clampdown on sick leave for 'burn out'," *The Local*, August 10, 2007.

networks and inter-firm learning. Indeed, high trust, learning capacity and networking competence are now widely perceived to be associated with relative economic and social success. […] Social capital is considered an asset, just like other traditional forms of capital. It is attained through the processes of interaction and learning that take place in society. However, unlike other commodities, it cannot be traded or exchanged. To some extent, it has become a concept for defining 'the missing ingredient' in successful practice that economics cannot explain."[493] Her study, which pointed to the soft power of social coherence in organizational achievements, concluded that "We interpret the industrial rise of the Mondragon region as an endogenous growth process. In essence, this growth process was achieved through interaction and cooperation based on the local economic, geographical and cultural context."[494]

Prof. Parıltı finds "lack of consciousness and market failures" to be "the leading challenges to cooperativism," but recognizes Islam as a positive context that supports cooperative behavior in Turkey. He observed that "cooperatives are most developed in conservative societies that frown upon risk. Religion has always played a role in cooperative movements around the world. Turkish society is like that, too. Anatolian culture accommodates cooperative principles like solidarity, levelheadedness, and social service. People in Turkey would not reject such goals, and refuse to participate in cooperatives because they favor more aggressive pursuits for themselves." Mrs. Özcan concurred with the proposition that Islamic values are harmonious with the collective spirit advanced in cooperativism, but finds nothing specific to Islam in this relationship. She said "theoretical teachings of Islam such as the notions of alms or charity are congruent with the idea behind cooperativism. However, other religious traditions have similar practices, too. I consider scholarship on cooperativism on secular grounds to be more useful since religious references often distract ideas from their original roots. Good

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[493] Iosu Lizarralde, "Cooperatism, social capital and regional development: the Mondragon experience," *International Journal of Technology Management and Sustainable Development* 8/1 (2009): 28.
[494] Ibid., 30.

practices in cooperatives can be falsely attributed to Islam just as malpractices can be justified under the name of it."

Prof. Parıltı and Mrs. Özcan's points are parallel to the convictions of Mr. Karayalçın who argued that "any idea for a cooperative can attract public support as long as it is well-designed and organized." He rejected the conviction that consciousness of common people is a prerequisite for cooperatives' success. "People have to be organized around the benefits of the project," he noted. "If those who organize the project reach out to the people diligently, and articulate the benefits of the project to them clearly, then people understand and appreciate. That footwork has to be done, though. Cooperativism is in a way a missionary work. Energy should be maintained by diligence." Karayalçın argued that when cooperatives are constructed as inclusive organizations that mobilize people, then "they produce their own leaders from among their constituents. Energy to lead is not something that can be created by government's appointment of managers. If government partners with the public and articulates how a co-op serves their own interests, then good leaders emerge from within, because leader is a product of the sociological climate." He made a distinction between co-ops that "do produce concrete projects" and others that are in the business of providing routine service." He stated that "cooperativism's perceived decline in Turkey has to do with the fact that a vast majority of Turkish co-ops are routine service coops. Because they are not scrutinized the same as project co-ops, their contributions go unnoticed. More project-based co-ops would bring more attention to the true accomplishments of the cooperative movement in Turkey." Mr. Karayalçın unveiled that in KENTKOOP, they "have used the term *project democracy* to convey the role management paid to itself; and the term *project custodian* to articulate the expectations from members. […] When this happens and people realize that they have a real role in an organization, they approach it more wholeheartedly, and the project increases its chances of success. Our achievement with the Batıkent project led to the first and only municipal bond issue in

Turkish history. The bond earned a BBB from international rating agencies, and was sold in global markets."

For Mrs. Özcan, "competent and charismatic leaders with political connections are valuable for cooperatives just like other businesses. However, those cooperatives that do not have such managers can compensate their weakness in other ways. They can seek consulting help from their higher organizations, or outsource some functions like governmental relations to administrative service companies. There are also some examples that co-ops improved their business volume by associating with organizations with a reputation of reliability." Özcan pointed out that professional management consultants can help Turkish cooperatives to realize and improve the problem of "the entanglement of management and supervision." This point appears consistent with that of Odera who explains that "Without unduly interfering with the management of the SACCO [savings, credit and cooperative societies], the supervisory committee must be responsible for the SACCOs compliance with its bylaws, for enforcement of internal controls, and for oversight of the board itself. The supervisory committee should be held responsible for seeing that the board contracts and receives an annual external audit and for ensuring that all internal controls are in place and functioning properly."[495] Özcan noted "communal Turkish culture disallows co-op members in managerial roles and others with supervisory responsibility to often have relationships that are too close for them to do their jobs. In some co-ops, even family members do become managers and supervisors. It is an unnoticed conflict of interest."

3.5 A Broad Taxonomy of International Cooperative Challenges

How do the challenges in Turkish cooperativism line up against those in cooperative movements in other countries? This section addresses this question in an

[495] Odhiambo Odera, "Corporate Governance Problems of Savings, Credit and Cooperative Societies," *International Journal of Academic Research in Business and Social Sciences* 2/11 (2012): 99.

effort to identify similarities between cooperatives' issues around the world. Findings promise a further understanding of the relationship between cooperative performance and contexts.

3.5.1 Cooperative Challenges in Developing Countries

Issues identified in the interviews are consistent with other research conducted on Turkish cooperativism, which recognize *difficulties in financing*, *state-cooperative relationship*, *unsupportive legal framework*, *low human capital inside cooperatives*, *training insufficiencies, poor public image* as the main problems.[496] These issues are also similar to those experienced by cooperative movements in other developing countries. International Labor Organization (ILO) reports that "[…] major obstacles to the development of cooperatives in developing countries include: misconceptions among policy-makers and planners of what cooperatives are and how they work; unrealistic expectations of what cooperatives can actually accomplish; the establishment of cooperatives irrespective of whether or not the minimum requirements for successful cooperative development are met; and the artificial acceleration of cooperative growth."[497] These issues exist against an historical background of colonialism as in many developing nations –such as Vietnam, Ethiopia, Sudan, Mali and Tanzania- where cooperatives were established by colonial governments with a top-down approach. These nations generally perceive cooperatives as government agencies rather than community organizations. Most co-op members in these countries are unaware of their rights and responsibilities as members, and participate minimally to their co-ops' governance. Colonial legacy rendered cooperatives public image as "[…] state-

[496] T.C. Gümrük ve Ticaret Bakanlığı [Turkish Ministry of Customs and Trade]. Kooperatifçilik Genel Müdürlüğü [General Directorate of Cooperativism]. Türkiye Kooperatifçilik Stratejisi ve Eylem Planı [Turkish Cooperativism Strategy and Action Plan]. Ankara, Turkey, 2012; Ziya G. Mülayim, *Kooperatifçilik* [Cooperativism] (Ankara, Turkey: Yetkin, 2010); and Erkan Rehber, *Kooperatifçilik* [Cooperativism] (Bursa, Turkey: Ekin, 2011).
[497] International Labor Organization. "Report V(1): Promotion of cooperatives," http://www.ilo.org/public/english/standards/relm/ilc/ilc89/pdf/rep-v-1.pdf.

sponsored, economically inefficient and socially defunct organizations, which put the interests of either the state or paid professional managers before those of their members."[498]

Colonial powers' establishments of cooperatives to monopolize agricultural markets and control crop prices in dominions have created distinct public roles and images for co-ops in countries with a history of colonialism. Financed solely by the colonial governments of France, Portugal and Belgium, co-ops in countries like Nigeria, Egypt, Ghana, Kenya and Rwanda have become "vehicles for political patronage and nepotism" while cooperativism has been "a system of co-operatives without co-operators."[499] A World Bank study on the issue revealed that financial sources behind these imperial co-ops were partly responsible from their use as mechanisms of exploitation.[500] This troubled position of cooperatives is so prevalent and accepted in colonized nations that an ICA study in 1966 found that even cooperativists in these countries were in favor of an authoritarian and controlling state involvement in cooperatives.[501]

This attitude is parallel to transition economies such as Romania where cooperatives "have credibility problems because they are associated with the communist ideology."[502] This was largely an outcome of the fact that agricultural cooperatives were formed to forcefully collectivize farmland around the country when communist regime was established in the aftermath of the WWII. Ingraining an authoritative and exploitative image of cooperativism in public consciousness, this public image exists to

[498] Ibid., p. 13.
[499] Linda Shaw, "Overview of Corporate Governance Issues for Co-operatives," Global Corporate Governance Forum discussion paper (February 8, 2007): 17. http://www.ifc.org/wps/wcm/connect/3aa7450048a7e6f1a93fef6060ad5911/GCGF_Discussion_Paper_Corporate_Governance_Issues_for_Cooperatives_070108.pdf?MOD=AJPERES.
[500] Pekka Hussi, Josette Murphy, Ole Lindberg, and Lyle Brenneman, *The Development of Cooperative and Other Rural Organizations* (Washington, DC: World Bank Technical Paper Series, 1993).
[501] Shaw, 18.
[502] Mihaela Lambru and Claudia Petrescu, "Surviving the crisis: Worker cooperatives in Romania," *Organization* 21 (2014): 741.

become a major obstacle for Romanian cooperative movement. Lambru and Petrescu note “Interviews with worker cooperative representatives reiterate the belief that these stereotypes have had a long-term negative effect which translates into decision makers’ lack of interest in cooperative needs and concerns as well as into the exclusion of these entities from various grant programs.”[503]

Piñeiro’s study on Venezuelan cooperativism finds that deficiency in administrative and technical skills, and financial dependence to public funds are the greatest problems in this country.[504] Not-for-profit cooperatives often find it difficult to attract talented managers, and inadequate levels of self-confidence and social consciousness lead to lack of initiatives in the cooperative sector. Other studies in India, which is the county with the largest cooperative presence, [505] Indonesia, [506] China,[507] and Ethiopia [508] confirm that these deficiencies in intellectual capital and inability to self-finance challenge cooperatives in these countries, as well.

Structural adjustment programs since the 1980s consisted of a transformation of planned economies with a large economic role for the government to market economies that rely on private actors to organize production and distribution.[509] This transformation occurred at a time when international organizations’ focus shifted from urban growth to

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503 Ibid.
504 Camila Piñeiro, “Main Challenges for Cooperatives in Venezuela,” *Critical Sociology* 35 (2009): 841-62.
505 Banishree Das, Nirod Kumar Palai, and Kumar Das, “Problems and Prospects of the Cooperative Movement in India under the Globalization Regime” (paper presented at the XIV International Economic History Congress, Helsinki, 2006).
506 Wiwiek Harwiki and Ruswiati Suryasaputra, “Implementation of Cooperatives' Principles on Ranked-Cooperatives,” *Journal of Economics and Behavioral Studies* 6 (2014): 340-50.
507 Xiangyu Guo, Brian Henehan, and Todd Schmit, “Rural Supply and Marketing Cooperatives in China: Historical Development, Problems and Reform” (paper presented at the Annual Meeting NCERA-194 Improving the Management and Effectiveness of Cooperatively Owned Business Organizations, November 6-7, 2007, St. Paul, MN).
508 G.Veerakumaran, “Ethiopian cooperative movement: an explorative study,” (working paper, Department of Cooperatives, Mekelle University, Ethiopia, 2007), http://www.copac.org.za/files/Ethiopian%20Cooperative%20Movement%20by%20G.Veerakumaran.pdf.
509 İzak Atiyas, “Economic Institutions and Institutional Change in Turkey during the Neoliberal Era,” *New Perspectives on Turkey* 14 (2012): 45-69.

rural development and to disadvantaged groups such as minorities, women and indigenous peoples. Consequently, social economy organizations that are controlled by the government such as cooperatives have lost their attractiveness against new community organizations such as land trusts, non-profits, special interest organizations, and mutual societies.[510] Often *lacking support systems* such as a tradition of community organization or cooperatives' banks to provide advantageous loans, cooperatives that lost their public support failed to reorganize, and discontinued their operations.

In the short-run, neoliberal restructuring was associated with a number of challenges for cooperatives in developing economies in transition. Rapid rise in unemployment rate as a result of widespread privatizations and inflationary conditions as a result of lax fiscal policies compromised solvency in many financial cooperatives. Unreliability of credit on favorable terms supplemented increases in food prices due to elimination of agricultural subsidies, and increases in transportation costs in response to market-oriented energy policies. Contraction in economic output reduced the size of domestic consumption markets for cooperatives, most of which were oriented domestically. In the longer run, free market reforms hampered cooperative movements further by compelling cooperatives to pursue scale. Faced with competition from large international organizations, many developing country co-ops had to involve in mergers in order to improve their scale against their competition. These mergers often resulted in failures due to governance issues or cultural incompatibility between the merging cooperatives.[511]

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[510] International Social Security Association, "Mutual benefit societies: A tool for developing social protection worldwide, particularly in the health sector" (paper presented at the 31st ISSA General Assembly World Social Security Forum, Doha, Qatar, November 10-15, 2013).

[511] Milford Bateman, "Cooperative Enterprise Development as a Key Aspect in Rebuilding Solidarity-Driven Local Economies in the Aftermath of Thirty Years of Destructive Local Neoliberalism" (paper presented at the UNRISD Conference on Potential and Limits of Social and Solidarity Economy, Geneva, Switzerland, May 6-8, 2013).

ILO points out that "A new balance between the power of the state in cooperative affairs (its regulatory, supervisory and promoting role) and an autonomous cooperative movement has yet to be reached in many countries. Legislative reforms in various areas are needed to reflect the general change and to provide the necessary equality in status for cooperatives so that they might compete on even terms with investor-driven enterprises."[512] Legal frameworks in many developing countries have been outpaced by market reforms. *Legislative conservatism* has created a mismatch between cooperatives' need for autonomy in order to survive in their increasingly competitive economies exposed to foreign competition, and bureaucratic circles' reluctance to sell their capital assets to cooperatives and relax their administrative control on these organizations. Taimni's study on Indian cooperative movement reveals that financial dependence to the state is a primary issue in Indian cooperatism as it is in other developing countries.[513]

3.5.2 Cooperative Challenges in Developed Countries

Despite the similarities in challenges faced by cooperatives in Turkey and other developing countries, a broader outlook on cooperative literature that includes research in developed countries suggests that cooperatives face a different set of issues in the developed world. ILO reports that *corporatization* presents a common threat for cooperatives in the developed world. To enhance their efficiency and competitiveness, cooperatives in developed countries merge with one another. While it resulted in fewer primary cooperatives serving a significantly larger member base over the course of the last four decades, cooperative mergers also diluted cooperatives' community purpose and converted them into "management-dominated general interest enterprises."[514] A recent quantitatively analysis of Mondragón Cooperative in Basque Country, Spain

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[512] ILO, p. 16.
[513] K. K. Taimni, "Asia's Rural Cooperatives: Origin, Evolution and Emerging Challenges," *Annals of Public and Cooperative Economics* 64 (1994): 481.
[514] Ibid., p. 21.

found that accomplishing growth goals creates its own peculiar set of challenges.[515] Cooperatives find it increasingly difficult to preserve their cooperative values in the face of expansion, which compromises their organizational strength in competition to commercial corporations.

Cooperatives in developed countries are vulnerable against *labor-saving technologies* and *cost-cutting operational relocations* that create unemployment. Increased unemployment reduces aggregate effective demand in the economy –further driving consumers toward low-cost corporations with outsourced inputs away from cooperatives with local, but more costly processes.[516] Research in Sweden and Finland showed that growing cooperatives in these countries are susceptible to losing their not-for-profit character.[517] When investments (especially in distribution networks) outpace cooperatives' ability to generate financing from within, cooperatives resort to external sources of financing to fulfill their growth potential. Reliance on short-term, high-interest borrowing accumulates into a debt burden that cooperatives cannot handle as not-for-profit enterprises. Consequently, they either grow by losing their special attitude towards profits, or refrain from pursuing more competitive scales in order to remain solvent and independent.

Cooperative movements in developed countries suffer from a different set of legislative challenges than those in developing countries. In Germany, cooperative laws were created and amended to address the needs of large cooperatives that define the cooperative movements in these countries.[518] High transaction costs make cooperatives an infeasible option for start-ups, and support services are often available only for large, established cooperative networks. Subsequently, cooperative movements grow more

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[515] Ramon Flecha and Pun Ngai, "The challenge for Mondragon: Searching for the cooperative values in times of internationalization," *Organization* 21 (2014): 666-82.
[516] ILO, p. 23.
[517] Sven A. Book and Kaj Ilmonen, "Problems of Contemporary Cooperatives: Consumer Cooperatives in Sweden and Finland 1960-80," *Economic and Industrial Democracy* 10 (1989): 513.
[518] ILO, p. 23.

slowly in developed countries with *less inclusive legislative institutions* compared to others such as Finland and England, which provide conditions conducive to establishment of new and small cooperatives.[519] Smith and Rothbaum observe that cooperative laws in the United States provide disincentives for potential cooperative entrepreneurs by denying them any privileges when membership body grows. They drive entrepreneurs towards other forms of businesses that allow them to reap the benefits of investment risk and burden in the long run.[520]

McPherson recognizes unavailability of data as the foremost challenge for cooperative sector in Canada. Social economy enterprises would benefit greatly from expansion of "[…] resources based on co-operatives, easily accessed and drawing upon the best in research […] by academic and other researchers as well as by practitioners willing to share their experiences. […] an on-line, multi-media, multi-site resource that would bring together many researchers, activists, and organisations to develop the kind of resources base the international movement desperately needs" would attract policymakers' attention to the socioeconomic value created by social economy enterprises.[521]

In developed countries where cooperative members are more actively engaged in management, organizational change poses a management challenge as in other non-investor owned enterprises. As Holmström argues, "the biggest dilemma for a cooperative […] is that change itself is bound to increase tensions among its members. […] Change upsets the established mechanisms for decision making and cooperation,

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[519] ILO, p. 23.
[520] Stephen C. Smith and Jonathan Rothbaum, "Cooperatives in a Global Economy: Key Economic Issues, Recent Trends, and Potential for Development" in *Co-operatives in a Post-Growth Era: Creating Co-operative Economics*, ed.s Sonja Novkovic and Tom Webb (London: Zed Books, 2014), Ch. 12.
[521] Ian MacPherson, "The Co-operative Movement in the Next 100 Years: What are the Opportunities? The Challenges?" (speech, Vancouver, October, 2010), Canadian Worker Co-op Federation, http://www.canadianworker.coop/resources/documents/co-operative-movement-next-100-years-what-are-opportunities-challenges.

[… and] it trends to cause the preferences to diverge […].”[522] In a rapidly changing world, this condition leaves cooperatives between their constant need for change, and their role as organizations that “have traditionally [been] developed where life has been more stable” for the purpose of “dampen[ing] the impact of change.”[523]

Other studies on developed country cooperatives acknowledge that macroeconomic factors attached to neoliberal policies provide a hostile environment for cooperatives in these economies. Gray and Kraenzle suggest that decreases in commodity prices partly as a result of food imports from lower-cost agricultural economies, and increases in labor costs are two factors that compromise profitability in farming co-ops in the U.S.[524] In Asia, Japanese cooperative sector is argued to have been weakened by financial deregulations that expanded competitive advantages for commercial banks to the expense of credit unions.[525]

3.6 Findings and Discussion

Table 4 presents an overview of the select group of studies on cooperativism reviewed. It illustrates that developing country cooperatives are challenged mainly by the issues about *financing*, *governance*, *education*, *public image* and *government-relations* whereas contextual challenges take the form of *corporatization*, *over-expansion*, *outsourcing*, *technology*, *legal exclusiveness,* and *dependence to commercial economy* in cooperatives in the developed world.

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[522] Bengt Holmström, “The Future of Cooperatives: A Corporate Perspective,” *The Finnish Journal of Business Economics* 4 (1999): 414.
[523] Ibid., p. 416.
[524] Thomas W. Gray and Charles A. Kraenzle, “Problems and Issues Facing Farmer Cooperatives,” (research report, Office of Rural Development, U.S. Department of Agriculture, Washington, DC, 2002), http://www.rurdev.usda.gov/rbs/pub/rr192.pdf.
[525] Mark Klinedinst and Hitomi Sato, “The Japanese cooperative sector,” *Journal of Economic Issues* 28 (1994): 509-17.

Table 4. Select literature on cooperative performance, scope and findings

Source	Analyzed Country		Challenges
	Developing[526]	**Developed**	
ILO (2001)	All		. Lack of co-op knowledge . Unrealistic expectations . Premature start-ups . Artificial growth
Hussi et al. (1993)	Former colonies		. Co-ops' use in political patronage . Financial dependence to government
ILO (2010)	Vietnam Tanzania Ethiopia Mali Sudan		. Government control . Lack of understanding in member rights and responsibilities
Turkish Ministry of Customs and Trade (2013)	Turkey		. Financing . Legal complexities . Low human capital . Lack of training . Poor public image
Harwiki & Suryasaputra (2014)	Indonesia		. Shortage in intellectual capital . Financing
Guo, Henehan & Schmit (2007)	China		. Lack of a sense of ownership . State control

[526] World Bank's current classification for developed and developing countries has been used. http://data.worldbank.org/about/country-and-lending-groups.

Veerakumaran (2007)	Ethiopia		. Marketing skills . Financing
Das, Palai & Das Taimni (2006)	India		. Financial dependence . Inability to attract skilled labor
Shaw (2007)	Nigeria Egypt Ghana Kenya Rwanda		. Lack of cooperative spirit . Poor public image . Financial dependence to government
Piñeiro (2009)	Venezuela		. Skill deficiency . Financial dependence . Lack of social consciousness
Lambru & Petrescu (2014)	Romania		. Poor public image . Exclusion by government
ILO (2001)		All	. Corporatization . Outsourcing . Labor-saving technologies
Holmström (1999)		All	. Change-induced governance issues
Smith & Rothbaum (2014)		USA	. Legal disincentives for co-op entrepreneurship
Gray & Kraenzle (2002)		USA	. Free trade . Wage increases
Book & Ilmonen (1989)		Sweden & Finland	. Corporatization . Dependence to commercial lenders

Klinedinst & Sato (1994)		Japan	. Financial deregulations
MacPherson (2010)		Canada	. Lack of data
ILO (2010)		Germany	. Legal disincentives for co-op entrepreneurship
Flecha & Ngai (2014)		Spain	. Corporatization

The difference in the nature of challenges in developed versus developing countries can be explained with a number of differences between these countries. A leading one of these differences is the scope of state involvement in the historical existence of cooperative movements.[527] Over the last two centuries, cooperatives in developed countries (of the present day) have conventionally relied on their own resources to remain competitive. On the other hand, cooperatives in developing countries have generally been seen as public entities that are controlled or owned by national governments. This perception compromised the penetration of self-determination and initiative into the cultural core of cooperativism –transforming them into parastatal organizations that operate outside the state but serve political ambitions independent from the needs of their congregations.

Another influential difference could have been the nature of businesses in which cooperatives are involved in developed and developing countries. In industrialized economies, cooperatives exist primarily in technical fields such as health care, retail, housing, management, insurance/banking, and manufacturing. In contrast, cooperatives are formed in less technical fields such as agriculture, marketing, utilities and handicrafts in less-industrialized countries. Difference in required technical skills translates into different levels of consciousness in cooperative movements around the world. This disparity manifests itself as cooperatives' compromised ability to attract

[527] The United Nations Social Policy and Development Division, "Background paper on cooperatives," accessed January 16, 2015, http://www.un.org/ar/events/cooperativesday/pdf/more.background.info.pdf.

members, and find funding from non-governmental sources. Lower level of consciousness also associates with cooperative members' lack of appreciation about cooperatives' profit-making purpose, which further jeopardizes their financial viability.[528]

A last characteristic that could explain why cooperatives face a different set of challenges in developing countries is the very description of "development." By definition, developed economies are those in which more conducive conditions for business exist. All forms of businesses, including but not limited to cooperatives, find a more favorable climate to flourish in developed economies. In their economic environment characterized by consumers with large effective demand, reliable and quality-driven suppliers, and a business-friendly government tradition; developed country cooperatives face challenges in later phases of their existence than the formation stages at which developing country cooperatives struggle to survive.[529]

These findings contribute to the literature on cooperative studies in two ways: Firstly, they suggest that contextual factors explain cooperative performance as much as organizational features do. While the cooperative form may be creating an organizational context conducive to stability, its competence in reaching this potential is a product of its interaction with the practical contexts in which it exists. Secondly, contextual challenges cooperatives face appear to diverge across developmental lines. They are *growth-oriented* issues that compromise their ability to grow faster such as

[528] An anecdote the author witnessed in an international cooperative workshop in Turkey in 2014 illustrated this challenge. At the ILO/ICA/TURKKOOP Workshop on Cooperatives Education (Ankara, April 25, 2014); a board member in a local cooperative questioned the depiction of cooperatives as "businesses" in a way that implies profit purpose. Klaus Niederlander, the head of ICA-Europe, had to respond to the cooperativist with an explanation of a fundamental feature in cooperatives –that profit-making is a core element of cooperatives that compete in a capitalistic economy, and what separates cooperatives from commercial businesses in terms of profits is that cooperatives operate to make rather than maximize profits.

[529] Geeta Batra, Daniel Kaufmann and Andrew H. W. Stone, *Investment Climate around the World: Voices of the Firms from the World Business Environment Survey* (Washington, DC: The World Bank, 2003).

corporatization, globalization, technological takeover, profit pressures from commercial lenders, exclusive legal framework in developed countries, but *existential* issues that threaten their very viability such as bureaucratic hurdles, poor governance, corruption due to ineffectual auditing, and inability to be funded by self-financing in developing countries. These findings are consistent with the fact that cooperatives represent a larger share of the national output in developed economies than in the developing ones, and this share has grown consistently over the last century.[530] Their revenues represent 28% of the GDP in France, 16% in the U.S. and 14% in Germany.[531] Nearly every other American is a member to a cooperative, and the total number of Americans who are part-owners of a co-op are more than those who are part-owners in a publicly trading company. In France, 60% of all deposits are made to cooperative banks, 25% of all retailers are co-ops, and 90% of farmers are co-op members. Switzerland's largest retailer and largest private employer are co-ops, and over nine million family farmers are members to cooperatives that provide over quarter million jobs in Japan.[532] The largest 300 cooperatives represent enough income ($2 trillion) to be the 9th largest economy in the world. Indeed, "cooperatives exist in the most competitive economies in the world and in most of the economic sectors."[533] As the European Commission acknowledges, they "[…] are an important part of European economic life and industry" [534] as one every three EU citizens (163 million) is an owner to a coop, and approximately 250,000 co-ops employ 5.4 million people within the EU.

Findings from this chapter point to an intriguing predicament about cooperativism from a global perspective: Developing nations need cooperativism to

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[530] Henry Hansmann, "Cooperative Firms in Theory and Practice," *Finnish Journal of Business Economics* 48, no. 4 (1999): 387.
[531] The International Cooperative Alliance. "Global 300 Report 2010: The World's Largest Cooperatives and Mutual Businesses." Accessed March 28, 2013. http://ica.coop/sites/default/files/media_items/Global300Report2011.pdf.
[532] ILO online. Interview with Hagen Henry. *ILO*. April 23, 2009.
[533] The International Cooperative Alliance, p.2.
[534] The European Commission. "Small and Medium-Sized Enterprises." Accessed March 28, 2013. http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/social-economy/co-operatives/index_en.htm#h2-1.

reverse the socioeconomic problems exacerbated by neoliberal policies, which expose them to foreign competition and drive them towards higher economic injustice and insecurity, however, they face significant suboptimalities in basic contextual factors that have to be supportive for cooperativism to flourish. Accordingly, policy frameworks to reintroduce cooperativism as an instrument for development need to not only provide solutions to problems that appear on the surface (financial dependence, governance issues, auditing challenges, and alike), but also address more deeply-rooted causes that underlie these problems (social trust deficit, lack of confidence among individuals, cultural disavowal of self-reliance, deficiency in government's respect for citizens). Competent implementation of such policies would endorse revival of cooperativism, which would in turn accelerate socioeconomic development towards an even better future for itself as well as the society.

In Conclusion section, summary of the arguments in the three essays, the ways by which they are examined, and their findings and limitations are presented.

CONCLUSION

"As the twentieth century came to an end," historian Ian MacPherson wrote, "much of the world became caught up in deepening commitments to competitive views of human history and to the idea that competition was the only sure way of ensuring 'progress'. The decline of centrally planned economies, correctly or not, was viewed by many, especially in positions of economic and political power in the West, as a climactic defeat of collective approaches; the victory of the 'market' as a triumph for indulgent and guilt-free individualism."[535] Yet the Great Recession of 2007-2009 painfully demonstrated that a perception of economics based on socially-indifferent competition consistently drives individuals, sectors and economies towards failure and instability. In order to restore its perception and credibility as a social science that furthers living standards of all people indiscriminately, economics profession needs to readopt normative concerns such as social responsibility and ecological sustainability,[536] which it had excluded under the pretense of being a positive science. The supposition that accuracy of assumptions is irrelevant as long as a model has high predictive ability[537] has to be replaced with a new paradigm that seeks to be reliable not only in its predictive capacity, but also in its assumptions and priorities. Consistent with the approach that "solution is no longer necessarily a set of mathematical conditions but a pattern, a set of emergent phenomena, a set of changes that may induce further changes, a set of existing entities creating novel entities;"[538] new economic thinking ought to welcome discussions of heterodox ideas such as austere growth policies,[539] expansionary regulations, and

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[535] Ian MacPherson, "Community, Individuality and Co-operation: the Centrality of Values," in *The Hidden Alternative: Co-operative Values, Past, Present and Future*, ed. Anthony Webster et al. (Tokyo: United Nations University Press, 2011), 207.

[536] Neva Goodwin et al., *Principles of Economics in Context* (New York City: Routledge, 2014), XVI.

[537] Milton Friedman, Essays in Positive Economics (Chicago: University of Chicago Press, 1953).

[538] W. Brian Arthur, "Complexity Economics: A Different Framework for Economic Thought", (working paper, Santa Fe Institute, Santa Fe, NM, 2013), http://tuvalu.santafe.edu/~wbarthur/Papers/Comp.Econ.SFI.pdf.

[539] Panagiotis Petrakis and Bülent Temel, "The Theory of Austere Growth: Baltic and Greek Experiences in the Eurozone Crisis," reviewed by *Eastern European Economics* (November 13, 2013).

restricted free trade on the policy level, and worker-owned businesses,[540] ESOPs (Employee Stock Ownership Plans), TIPs (Targeted Investment Programs),[541] or CDCs (Community Development Corporations)[542] on the organizational level.

This dissertation examines the potential cooperativism offers as a remedy to the challenges experienced in contemporary political economy. Chapter 1 puts forth the argument that organizational structure and the rationality associated with it need to enter the discourse on financial stability as an explanatory variable. It is argued that organizational structures create contexts to which organizations respond, and accordingly; organizational -and indirectly and to lesser degrees, sectoral and economic- stability can be supported by subsidizing the right forms of organizations in the economy. Of these organizational forms, cooperative form promises policy instrumentality with its distinct characteristics and sensitivities. Conceptual framework of cooperative theory is used to make the case of cooperativism as a stability factor.

Chapter 2 examines the stability potential of cooperativism in a narrow sector with actual data. Using quarterly data from Canadian financial sector between 2000 and 2010, a composite managerial risk index (CMRI) is introduced to quantify risk propensity financial organizations display. A panel data analysis that consider growth in GDP, M3 money supply, TSX share values and profitability is performed to observe and compare risk levels in the largest ten cooperative and commercial banks in Canada. Findings support the argument that organizational structure is associated with risk appetite, and cooperative form is more conducive to organizational stability than the commercial corporate form.

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[540] Total number of worker-owners exceeds that of union members in the private sector in America today. Source: Gar Alperovitz, America Beyond Capitalism: Reclaiming Our Wealth, Our Liberty and Our Democracy (Hoboken, NJ: John Wiley & Sons, 2005), 81.
[541] TIPs are pension fund investments into location-based causes. They are a rapidly growing form of public investments, which is adopted by more than 25 states in the US.
[542] CDCs are not-for-profit organizations established for the sole purpose of facilitating and accelerating local development in small districts.

In Chapter 3, the link between cooperative performance and the larger social, economic, political and legal contexts to which they are exposed is examined. Interviews with four the most prominent cooperativists in Turkey provide a picture of the challenges cooperatives face in this country as they exist in various contexts. These challenges are reviewed against the challenges reported in a select group of countries in order to identify commonalities in these countries. Findings suggest that cooperative challenges diverge developmental lines. In developing countries, contextual challenges take *existence-relevant* forms that jeopardize cooperatives' ability to remain solvent whereas in developed countries, they are in *competition-relevant* forms that compromise cooperatives' competence in reaching their growth potential. This observation reveals a predicament in 21st Century cooperativism: developing countries increasingly need social economy solutions such as cooperativism in order to mitigate the negative consequences of market fundamentalism; however they seem to harbor substantial suboptimalities in their basic social, economic, political and legal contexts that have to be conducive to cooperatives' rise to prominence. Therefore, policymakers who aspire to revitalize cooperativism need to not only address the problems from which cooperatives suffer directly, but also improve the contextual issues that exist in cooperatives' operational environment.

Research in this dissertation offers a number of limitations: Firstly, practical instrumentality of its findings has less-than-universal applicability. As Rodrik notes, "Institutional repertoire available in [… one country] may be inappropriate to the needs of [another]. […] The view that one set of institutional arrangements necessarily dominates others in terms of overall performance is a common journalistic error."[543] Accordingly, the indication in Chapter 2 that cooperative banks perform more stably than commercial banks offer only tentative insights to contexts other than those

[543] Dani Rodrik, "Institutions for High-Quality Growth: What They Are and How to Acquire Them," *Studies in Comparative International Development* 35 (2000): 10-12.

prevalent in observed Canada. On a wider perspective, some grand institutions such as participatory democracy can be convincingly argued to be a "*meta-institution* [with a capacity to] elicit and aggregate local knowledge and thereby help build better institutions,"[544] however the claim for global applicability for a micro institution like cooperativism would be less than impenetrable.

Secondly, CMRI indicator presented in Chapter 2 has usability only under a restricted set of conditions. Due to the difficulty of descriptively determining the threshold level of risk at which further risk-taking is not justified with marginal returns from the risk, CMRI treats all levels and types of risks identical. Accordingly, it presents a perception of risk that considers it as *any* (not just *excessive*) delegation of control on matters that have personal consequences. Moreover, CMRI does not provide a suitable tool for international comparisons in the absence of a unified effort to collect data globally. Because it shows outcomes of an indexing procedure, which produces values based on the position of individual subjects in relation to the others; CMRI values would be incomparable across different data sets. For a particular CMRI score for a bank to represent the same level of managerial risk in another bank in a different country, data from both countries' banks have to be compiled into a single set of data that treats the two countries as one market. Therefore, CMRI's usability as an international risk indicator requires pooling of all financial institutions in all observed countries into a single dataset.

Thirdly, classification of countries with a diverse range of geographies, histories, conditions, assets and challenges in only two classes (*developed countries* and *developing countries*) in Chapter 3 is vulnerable against oversimplification. Contexts that influence cooperatives would vary from one developing (or developed) country to another more than it is assumed in the present study –compromising the analyzed capacity of contexts to explain cooperative behavior across developmental lines.

[544] Ibid., 14.

Therefore, it would be prudent to approach the findings about cooperative challenges in the third essay with cognizance that general commonalities observed in the analysis are not stand-alone phenomena; they are instead only a part of a larger set of cooperative challenges that include country-specific challenges in each observed country.

A final limitation of the third essay worth noting is its abstraction of all cooperatives as a single reality behaving in a unified fashion. Although the chapter acknowledges the differences in the types of cooperatives as a potential explanation for the observed difference in cooperative challenges around the world, its wide global outlook inescapably requires an assumption that cooperatives' responses to their contexts do not vary from one type of cooperative to another. Accordingly, cooperative type is overlooked as a potential determinant of cooperative behavior in order to examine the role of contexts on cooperative performance. For example, if a developing country like Ukraine where agriculture's share in GDP is 10% has a significantly higher concentration of agricultural coops than Norway where agriculture represents 1.5% of the GDP, then the challenges cooperative movements in these countries face could be more explainable by the composition of their cooperative sectors than the development statutes of their economies. This shortcoming was articulated in the section on Turkish cooperativism, which acknowledged the possibility that the identified problems of Turkish cooperativism could be attributable to these cooperatives' operational market being a developing country –rather than being Turkey specifically. Nonetheless, this shortcoming still exists in the analysis –inviting future research that would analyze cooperatives based on their types in addition to the development level of the economies in which they operate. Findings from such future research promise as valuable insights into the potential of cooperativism in the 21st Century as the findings about the relationship between context and cooperative performance.

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ANNEXES

Annex 1. Indexed CMRI values for banks (2000-2012, quarterly)

Period	Index CMRI,RBC	Index CMRI,TD	Index CMRI,SCOT	Index CMRI,BMO	Index CMRI,CBIC
12/Q4	0.954	0.955	0.948	0.95	0.948
12/Q3	0.956	0.957	0.95	0.95	0.948
12/Q2	0.954	0.946	0.951	0.95	0.948
12/Q1	0.957	0.95	0.957	0.951	0.945
11/Q4	0.947	0.95	0.953	0.945	0.94
11/Q3	0.944	0.952	0.95	0.945	0.942
11/Q2	0.941	0.95	0.95	0.939	0.945
11/Q1	0.941	0.949	0.954	0.943	0.939
10/Q4	0.946	0.95	0.955	0.942	0.944
10/Q3	0.945	0.949	0.955	0.942	0.943
10/Q2	0.942	0.95	0.956	0.942	0.944
10/Q1	0.944	0.951	0.956	0.946	0.947
09/Q4	0.944	0.951	0.959	0.948	0.95
09/Q3	0.946	0.951	0.962	0.953	0.935
09/Q2	0.952	0.952	0.966	0.958	0.954
09/Q1	0.957	0.956	0.969	0.962	0.958
08/Q4	0.964	0.96	0.971	0.963	0.955
08/Q3	0.957	0.951	0.963	0.962	0.716
08/Q2	0.959	0.952	0.97	0.964	0.953
08/Q1	0.961	0.95	0.968	0.966	0.952
07/Q4	0.959	0.954	0.967	0.962	0.957
07/Q3	0.957	0.953	0.97	0.965	0.956
07/Q2	0.955	0.953	0.967	0.965	0.955

07/Q1	0.954	0.948	0.973	0.965	0.955
06/Q4	0.953	0.953	0.974	0.963	0.957
06/Q3	0.953	0.953	0.979	0.965	0.959
06/Q2	0.953	0.953	0.981	0.964	0.958
06/Q1	0.952	0.954	0.978	0.963	0.955
05/Q4	0.951	0.964	0.984	0.964	0.954
05/Q3	0.953	0.963	0.982	0.965	0.953
05/Q2	0.952	0.962	0.974	0.964	0.939
05/Q1	0.955	0.953	0.977	0.967	0.947
04/Q4	0.951	0.952	0.971	0.965	0.946
04/Q3	0.952	0.957	0.973	0.965	0.943
04/Q2	0.949	0.954	0.974	0.964	0.95
04/Q1	0.95	0.957	0.976	0.964	0.953
03/Q4	0.951	0.955	0.975	0.963	0.944
03/Q3	0.95	0.961	0.973	0.965	0.95
03/Q2	0.951	0.967	0.973	0.966	0.96
03/Q1	0.946	0.966	0.973	0.965	0.952
02/Q4	0.945	0.968	0.973	0.968	0.947
02/Q3	0.946	0.967	0.976	0.967	0.951
02/Q2	0.946	0.963	0.969	0.97	0.955
02/Q1	0.942	0.963	0.966	0.968	0.956
01/Q4	0.943	0.962	0.963	0.968	0.958
01/Q3	0.935	0.96	0.964	0.979	0.957
01/Q2	0.938	0.961	0.972	0.981	0.958
01/Q1	0.937	0.964	0.971	0.977	0.954
00/Q4	0.941	0.964	0.973	0.98	0.955
00/Q3	0.932	0.958	0.969	0.98	0.958
00/Q2	0.928	0.968	0.969	0.986	0.958
00/Q1	0.929	0.955	0.972	0.981	0.956

Annex 2. Indexed CMRI values for credit unions (2000-2012, quarterly)

Period	Index CMRI,VCU	Index CMRI,CCS	Index CMRI,SCU	Index CMRI,MCU	Index CMRI,DG
12/Q4	0.906	0.918	0.842	0.884	0.911
12/Q3	0.906	0.927	0.843	0.882	0.909
12/Q2	0.903	0.922	0.839	0.875	0.909
12/Q1	0.897	0.917	0.843	0.872	0.910
11/Q4	0.897	0.903	0.842	0.868	0.908
11/Q3	0.895	0.895	0.837	0.847	0.905
11/Q2	0.891	0.895	0.829	0.833	0.905
11/Q1	0.893	0.893	0.832	0.824	0.906
10/Q4	0.892	0.891	0.825	0.796	0.909
10/Q3	0.891	0.894	0.828	0.792	0.905
10/Q2	0.890	0.900	0.831	0.790	0.908
10/Q1	0.890	0.903	0.838	0.785	0.909
09/Q4	0.892	0.909	0.839	0.786	0.908
09/Q3	0.888	0.905	0.838	0.781	0.910
09/Q2	0.897	0.901	0.819	0.789	0.910
09/Q1	0.905	0.907	0.789	0.794	0.917
08/Q4	0.913	0.912	0.755	0.794	0.916
08/Q3	0.909	0.911	0.702	0.785	0.914
08/Q2	0.914	0.915	0.699	0.790	0.916
08/Q1	0.912	0.920	0.692	0.787	0.916
07/Q4	0.916	0.923	0.683	0.789	0.916
07/Q3	0.912	0.918	0.674	0.793	0.917
07/Q2	0.910	0.913	0.673	0.788	0.914
07/Q1	0.909	0.920	0.679	0.803	0.908
06/Q4	0.912	0.919	0.678	0.798	0.910

06/Q3	0.908	0.924	0.714	0.791	0.911
06/Q2	0.907	0.919	0.675	0.798	0.911
06/Q1	0.913	0.918	0.668	0.782	0.908
05/Q4	0.909	0.909	0.675	0.761	0.901
05/Q3	0.903	0.917	0.632	0.748	0.900
05/Q2	0.899	0.913	0.632	0.718	0.900
05/Q1	0.905	0.920	0.634	0.705	0.898
04/Q4	0.903	0.919	0.656	0.640	0.894
04/Q3	0.903	0.921	0.674	0.650	0.895
04/Q2	0.888	0.916	0.639	0.562	0.894
04/Q1	0.889	0.915	0.657	0.566	0.890
03/Q4	0.888	0.927	0.608	0.631	0.888
03/Q3	0.902	0.933	0.613	0.580	0.888
03/Q2	0.899	0.917	0.633	0.543	0.890
03/Q1	0.897	0.911	0.599	0.595	0.887
02/Q4	0.897	0.916	0.673	0.428	0.886
02/Q3	0.882	0.911	0.595	0.598	0.889
02/Q2	0.901	0.909	0.509	0.605	0.886
02/Q1	0.904	0.908	0.485	0.570	0.889
01/Q4	0.887	0.892	0.476	0.353	0.881
01/Q3	0.877	0.886	0.465	0.354	0.884
01/Q2	0.882	0.883	0.238	0.366	0.885
01/Q1	0.888	0.881	0.337	0.379	0.893
00/Q4	0.887	0.874	0.434	0.349	0.897
00/Q3	0.890	0.890	0.377	0.321	0.908
00/Q2	0.889	0.877	0.290	0.327	0.911
00/Q1	0.888	0.872	0.319	0.319	0.917

SUMMARY IN TURKISH[545]

İktisat tarihinin en yıkıcı vakaları arasında yerini alan Büyük Durgunluk (2007-2009) topluma-kayıtsız rekabetçiliğe dayanan bir iktisat anlayışının bireyleri, sektörleri ve ekonomileri istikrarsızlığa sürükleyişinin son örneğini oluşturmuştur. İktisat biliminin seçici olmaksızın tüm bireylerin yaşam standardını yükselten bir toplumsal bilim olma algı ve saygınlığını yeniden tesis edebilmesi için bir pozitif bilim olma yanılgısı içinde kendisinden soyutlamakta olduğu düzgüsel hassasiyetleri yeniden benimsemesi gerekmektedir. İktisadı arz tarafından gören düşüncenin aksine, bu yeni paradigmanın öngörü becerisi gibi varsayım ve önceliklerinin de güvenilir olması şarttır. Bu durumda ortaya çıkacak kemer sıkmalı büyüme, genişletici kanuni düzenlemeler, kontrollü serbest ticaret, çalışanların-mülkiyetindeki işletmeler, hisse senediyle tazminat, semt kalkınması şirketleri gibi heterodoks fikirlerden bir tanesi de *kooperatifçilik*tir.

Bu çalışmada kooperatifçiliğin bütünleyici bir iktisat kuramı olarak çağdaş kapitalizmin ortaya çıkardığı olumsuz sonuçlardan aşırı risk iştahı sorununu azaltma potansiyeli incelenmiştir. 1. Bölüm Büyük Durgunluğun içeriği ve tarihsel önemini ele almış ve onun ortaya çıkardığı büyük yıkımın çağdaş iktisat anlayışının eleştirel sorgulamalarını meşrulaştırışını vurgulamıştır. Büyük Buhran'dan (1929-1939) bu yana görülen en uzun süreli yüksek işsizliğin (Kasım 2014'e kadar ardışık 24 çeyrek) yaşandığı, 12 milyon hanenin evinin mülkiyetini yitirdiği ve her yedi Amerikalıdan birisinin devletin dağıttığı yemek kuponlarıyla yiyecek ihtiyaçlarını karşılayabilir hale düştüğü bu devasa krizin ana unsurları yedi sene sonra bugün halen devam etmektedir. Tarihin en büyük niceliksel genişlemesine (3.5 Trilyon Dolar) rağmen bugün Amerikan ekonomisinde çıktının reel büyümesi çok yavaş, işsizlik oranı iki haneli rakamlarda ve tüketici ve iş kesimi güven seviyeleri yakın tarihin en düşük seviyelerinde seyretmektedir. Önceki durgunluklardan farklı olarak, işgücü üretkenliği halen kriz öncesi seviyesine ulaşamamış ve sanayi firmalarının piyasa değerleri kriz öncesinin

[545] Translation of the Conclusion Chapter presented above.

yarısı seviyelerine düşmüş bulunmaktadır. Bu gelişmeler sonucunda ana akım iktisadın işgücü piyasası esnekliği, finansal düzenlemelerin azaltılması, devletin ekonomideki rolünün enazlaştırılması ve şirket seçkinlerine vergi ayrıcalıkları gibi fikirlerinin erdemi sorgulanır olmuş ve A.B.D., Yunanistan, İspanya ve 1990'larda kapitalizm serüvenlerine neoliberal politikalarla başlayan eski Doğu Bloku ülkelerinde geniş halk protestoları yaşanmıştır.

Bölümün devamında genel olarak finansal krizlere ve özel olarak Büyük Durgunluğa dair yazınlar incelenmiştir. Kuramsal çalışmalar finansal krizleri ekonomik aktörlerin sistemden kısa sürede büyük miktarlarda kaynağı çekmeleri, piyasaların münferit olarak yaşadıkları likidite sıkıntısı, varlık fiyatlarındaki aşırı değerlenmelerin düzelmesi ve finansal kuruluşların yaşadıkları örgütsel stresin sektördeki diğer aktörlere, ekonomiye ve hatta diğer ekonomilere yayılması gibi etkenlerle açıklamaktadır. 2007'de başlayan kriz özelinde yapılan çalışmalar ise krizi finansal düzenlemelerin azaltılması, sermayenin uluslararası hareketliliği, politika yapıcılarının neoliberal iktisat ideolojisine batıl inançları sonucunda ivme kazanan aşırı finansallaşma ve menkul kıymetleşme, borçla yatırım ve tüketim, bozuk gelir ve servet dağılımı ve devlet müdahelesinden kaçınma gibi sorunlar ekseninde açıklamaktadır. Krize parasal açıdan yaklaşan gözlemciler ise söz konusu durgunluğun Amerikan kamu borçlanma senetlerine Asya ülkelerinin gösterdiği büyük talep, Amerikan Merkez Bankası'nın uzun süre sürdürdüğü düşük faiz politikası, riskli türev araçlarının finansal portföyler içindeki oranının aşırı yükselişi ve tutsat sektöründeki kayıpların sonrasında ikraz iştahının düşüşü gibi etkenlerin etkisiyle ortaya çıkan parasal dengesizliklerle ilişkisine dikkat çekmekte ve bu durumu iş devrinin katlanılması gereken konjonktürel bir gerçeği olarak sunmaktadır. Krizin psikolojik değerlendirmeleri ortaya çıkan aksaklıkların ortak kültürde tüketimin bir öz-gerçekleştirme aracına dönüşmesi, ekonomik büyüme dönemlerinde akademik değerlendirmelerin bir entellektüel atalet içine girmesi ve Amerikan karakterini gittikçe etkilediği ifade edilen narsisizmin ortaya koyduğu aşırı risk-alma ve kısa-vadecilik eğilimleri ile ilintisine vurgu yaparken, mevcut sisteme getirilen eleştirilerse kapitalizmde kâr hadlerinin düşme eğiliminde olması ve ekonominin büyümenin daha riskli borçlanmayı teşvik etmesi önermelerine odaklanmaktadır.

Bölümde Büyük Durgunluk yazınının krize zemin hazırlayan dinamikleri anlamada ve politika yapıcılarına önlem almaları için yol göstermede etkili olmakla beraber ideolojik motivasyonları yeterince kontrol etmediği öne sürülmüştür. Heterodoks analizler kapitalizme sistemik eleştiriyle meşguliyetleri yüzünden aşırı genel bir bakış açısını ortaya koymakta, ana akım çalışmalar ise ekonomideki çeşitli aktörler arasındaki ilişkileri, siyasal önderliklerin politikalarını ve çeşitli dengesizliklerin ortaya çıkardığı aksaklıkları sadece arz-taraflı bir bakış açısıyla ele almaktalardır. Bunun sonucunda yazında ortaya konulan açıklamalar krizde en merkezi noktada konumlanmış olan ekonomik aktörün -finansal kuruluşların örgütsel tasarımlarının- değerlendirilmesini gözden kaçırmaktadır. Mevcut çalışma finansal kuruluşların tasarımları ile risk tahammülleri arasındaki bağlantıyı inceleyerek bu boşluğa dikkat çekmeyi hedeflemektedir. Farklı örgütsel tasarımların farklı bağlamları ortaya çıkararak örgütsel aktörleri değişen toplumsal sorumluluk seviyeleri ile hareket etmeye yönelttiği hipotezi öne sürülmüştür. Bu bağlamda kooperatif-tarzı örgütlenmiş olan finansal kuruluşların bu özgün tasarımlarının etkisiyle şirket yönetimine daha temkinli bir yaklaşımı teşvik ettiği ve bunun makroekonomik şoklara daha yüksek bir dayanıklılık ve daha güçlü bir istikrarlılık ile sonuçlandığı savı incelenmiştir.

Bu yaklaşım krize hukuk sistemi, kültürel normlar, siyasal çıkarlar ve ekonomik güdüler gibi kurumların etkilerine odaklanarak yaklaşan kurumsal iktisat çalışmalarının genel düşünce sistematiği ile tutarlı olmasına rağmen ticari tasarımı finans sektörünün sabit ve kutsal bir öğesi olarak değil, bir risk teşviki olarak görerek Büyük Durgunluğu bu teşvik ile açıklamaya yönelmesiyle o çalışmalardan ayrılmaktadır. Bu bağlamda, kooperatifçilik kuramının *artık*, *çıkardaşlar*, *aktif mülkiyet*, *toplumsal sorumluluk*, *uzun-vadecilik* ve *ekonomik demokrasi* gibi kavramları içeren kavramsal çerçevesini kullanılarak ticari ve kooperatif bankalar arasındaki risk iştahı farkları değerlendirilmiştir. Kooperatifçilik kuramının özünde kâr kavramına alınan özel bir tavır yatmaktadır. Buna göre, kuruluşun amacı hissedarlarının (shareholders) maddi çıkarlarına hizmet etmek için *kâr maksimizasyonu yapmak* değil, çıkardaşlarına (stakeholders) hizmetin sürekliliğini sağlamak üzere *kâr yapmak*tır. Kooperatiflerin müşterileri, çalışanları ve/veya iş ortaklarından oluşan çıkardaşlarına hizmeti varoluşsal amaçları olarak benimseyişleri hissedarları ekonomik aktivitenin yegane lehdarı olarak gören sermaye şirketlerinden önemli bir farklılıklarına işaret etmektedir. Kooperatifçilik her üyeye kooperatife yaptığı maddi katkıdan bağımsız olarak bir oy hakkı vererek ve üst yönetimi seçip denetleyen yönetim kurulunun gönüllü üyelerden oluşmasını öngörerek iş ortamında demokrasi idealinin gerçekleştirilmesini sağlamaktadır. Kooperatifler şirket sahipleri, yöneticiler ve çalışanların sermaye şirketlerinde ayrışan çıkarlarını örtüştürerek toplumsal sorumluluğu teşvik eden toplumsal ekonomi/üçüncü sektör kuruluşlarıdır. Üyelerine hizmete odaklanmaları ve ticari kuruluşlardan borç alarak yatırım yapma uygulamasından sakınmaları kooperatiflerin örgütsel ihtiraslarını törpüleyerek ekonomik daralma dönemlerinde bile sürdürülebilirliklerini muhafaza etmelerine olanak vermektedir.

2. Bölüm kooperatif tasarımının örgütsel istikrarla ilişkisine dair önermeyi Kanada finans sektöründeki ticari ve kooperatif bankalar arasındaki risk iştahlarını değerlendirerek sınamaktadır. Bu amaçla Kanada Merkez Bankası tarafından kullanılan dört bilanço riski göstergesi finansal kuruluşlardaki risk iştahının stilize edilmiş bir genel göstergesi olarak Birleşik Yönetim Risk Göstergesi (CMRI) adı altında birleştirilmiştir. Sektördeki kuruluşlar kar maksimizasyonu amaçlı *ticari bankalar* ve kar maksimizasyonu amacı gütmeyen kooperatif bankalar (*kredi birlikleri*) olarak sınıflandırılmıştır. Sektördeki toplam varlıkların %90'ından fazlasını kontrol eden en büyük beş ticari ve beş kooperatif banka için 2000-2010 yılları arasındaki 52 çeyreğe dair veriler kullanılmıştır. Bu kuruluşların çeyreklik CMRI değerlerini bağımlı değişken, M3 para arzı ve reel toplam çıktıdaki çeyreklik değişimleri makroekonomik bağımsız değişken ve karlılık ve hisse değerlerindeki çeyreklik değişimleri örgütsel bağımsız

değişken olarak içeren bir panel veri analizi yapılmıştır. Tahminler kooperatifler tarzı örgütlenmiş olan finansal kuruluşların ticari örgütlenmiş olanlara kıyasla şirket yönetimine daha muhafazakar bir açıyla yaklaştıklarına dair savı desteklemiştir. Finansal hisse performansının risk iştahını etkilediği saptanırken reel çıktı ve para arzındaki değişimlerin finansal sektör yöneticilerin riske karşı aldıkları tavırla negatif ilişkili olduğu ortaya çıkmıştır. Değer ençoklaştırmasına dayanan örgütsel tasarım ve menkul kıymetleri içeren yönetici tazminatları hisse değerleri üzerine çevirdikleri odak ile ticari banka önderliklerinin örgütsel, sektörel ve –bankacılık sektörünün büyüme üzerindeki rolü düşünüldüğünde- makroekonomik istikrarı tehlikeye atabilecek risk seviyelerine katlanmalarını teşvik eder görünmektelerdir. Öte yandan karlılığın risk iştahı üzerindeki etkisi piyasa değerlerinin etkisinden daha farklı bulunmuştur. Bulgular birarada değerlendirildiğinde mülkiyet ve yönetim kontrolünün kendi (ve yerel) müşterileri ve çalışanlarında olduğu kooperatif tarzı bankaların (kredi birliklerinin) mülkiyetin hissedarlarda, yönetim kontrolünün ise kuruluş ile profesyonel bağı dışında bir ilişkisi olmayan yöneticilerde olduğu ticari bankalara göre daha düşük bir risk iştahıyla hareket ettiklerine dair önermeyi desteklemektedir.

Tezin kapsamı içindeki üçüncü ve son çalışmada kooperatifçiliğin çağdaş kapitalizm içinde temsil ettiği rekabetçilik potansiyeli kooperatiflerin içinde bulundukları bağlamlarla etkileşimleri ele alınarak incelenmiştir. Bu kısımda istikrarı teşvik eden bir örgüt-içi bağlam yaratan kooperatiflerin örgütsel olarak içinde bulundukları bağlamlara nasıl yanıt verdikleri sorusu araştırılmıştır. Bunun için, en çok kooperatife sahip ülkelerden birisi (84.000'den fazla) olmasına rağmen kooperatifçiliğin ulusal öneminin oldukça düşük olduğu Türkiye'de kooperatifçiliğin mevcut sorunları incelenmiştir. Türkiye'nin önde gelen kooperatifçilerinden dört tanesi ile mülakatlar yapılmış ve bu uzmanların Türk kooperatifçiliğinin önündeki engellere dair görüşleri alınmıştır. Görüşmeler Uludağ Üniversitesi'nin Tarım Ekonomisi Bölümü'ne 17 sene başkanlık yapmış ve Türk kooperatifçiliği üzerine yoğun bir yayın geçmişi bulunan Prof. Dr. Erkan Rehber, Türkiye'deki kooperatiflerin en üst organı olan Türkiye Milli

Kooperatifler Birliği'nin Genel Müdürü Sayın Leyla Özcan, Türkiye tarihinin en başarılı kooperatif projelerinden sayılan Kent-Koop yapı kooperatifinin 1981-1991 yılları arasında kurucu yöneticiliğini yapmış olan, T.C. eski Başbakan Yardımcısı (1994-1995) Sayın Murat Karayalçın ve Türk kooperatifçilik hareketinde tarihsel bir önemi olan Türk Kooperatifçilik Kurumu'nun başkanı ve Gazi Üniversitesi İşletme Fakültesi ögretim üyesi Prof. Dr. Nurettin Parıltı ile yapılmıştır. Uzmanların görüşleri Türk kooperatifçiliğinin çeşitli toplumsal, ekonomik ve siyasal bağlamlarla ilişkisine yönelik sekiz ana soru çerçevesinde derlenmiştir. Mülakatlar 1.5-2 saat arası sürmüş ve 2014 yılının Ocak ve Şubat aylarında yapılmıştır. Uzmanlar Türk kooperatifçiliğinin çektiği temel sıkıntıların *halktaki genel bilinç düzeyinin düşüklüğü*, *üçüncü sektöre kamu müdahalelerinin fazlalığı*, *özerk finansman seçeneklerinin yokluğu*, *etkisiz denetleme*, *yasal düzenlemelerden gelen ters teşvikler* ve *kooperatifçiliği desteklemeye dair siyasi irade eksikliği* konularında yaşandığını belirtmişlerdir. Bu saptamalar diğer gelişmekte olan ülkelerde yapılan benzer çalışmaların bulgularıyla uyumlu iken, gelişmiş ülkelerde saptanan *hızlı büyüme*, *küreselleşme*, *teknolojinin hakimiyeti*, *ticari finansman kaynaklarının baskısı* ve *dışlayıcı yasal çerçeve* sorunlarından farklılık göstermektelerdir. Bu çalışmanın ortaya koyduğu bulgular kooperatiflerin performansının içinde bulundukları bağlamlardan etkilendikleri, ancak bu bağlamları oluşturan öğelerin gelişmişlik hadlerine bağlı olarak değişkenlik arz ettiğine işaret etmektedir. Bağlamsal zorluklar gelişmekte olan ülkelerde kooperatiflerin kuruluş ve sürdürülebilirliğini tehlikeye atan varoluşsal şekiller alırken gelişmiş ülkelerde kooperatiflerin büyüme potansiyellerine ulaşma becerilerini sınırlayan rekabetsel şekiller almaktadır.

Bu tezin kapsamı içindeki incelemelerin ortaya çıkardıkları bulgular 21. Yüzyıl'da kooperatifçiliğe dair zorlu bir duruma işaret etmektedir: Serbest piyasa ekonomisinin olumsuz sonuçlarını azaltabilmek için kooperatifçilik gibi toplumsal ekonomi çözümlerine büyük ihtiyaç duyan gelişmekte olan ülkeler kooperatifçilik hareketinin ulusal öneme ulaşabilmesi için gerekli temel toplumsal, ekonomik, siyasal ve yasal bağlamlarda yadsınamaz eksiklikler içermektelerdir. Bununla birlikte kooperatifçiliğin doğası gereği kendi kendisini destekleyen bir hareket oluşu onun geleceğine dair ümit veren bir özelliğidir. Kooperatifçiliğin gelişimini engelleyen bağlamlardaki her gelişme sadece kooperatiflerin nitelik ve niceliklerinin artmasını desteklemeyecek, aynı zamanda kooperatiflerin bahsedilen sosyoekonomik faydaları sayesinde kendi gelişimine de ivme kazandıracaktır.

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Degree	Field of Study	University	Year
Undergraduate	Business Administration	Hacettepe University	2001
Graduate (Master's)	Public Administration	Harvard University	2009
PhD	Political Economics	Atılım University	2015

Professional Experience

Employer	Position	Year
Cambridge Institute for Dialectical Studies	Co-director	2015-Present
Southern New Hampshire University	Adjunct instructor	2012-Present
Atılım University	Research assistant	2010-2015
Edward Jones Investments	Financial advisor	2006-2009
Army & Air Force Exchange Service	Market economist	2002-2003

Language skills: Turkish and English

Publications:

Edited Books

The Great Catalyst: European Union Project and Lessons from Greece and Turkey. Lanham, MD: Lexington Books, 2013.

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Tez Bülent Temel tarafından

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