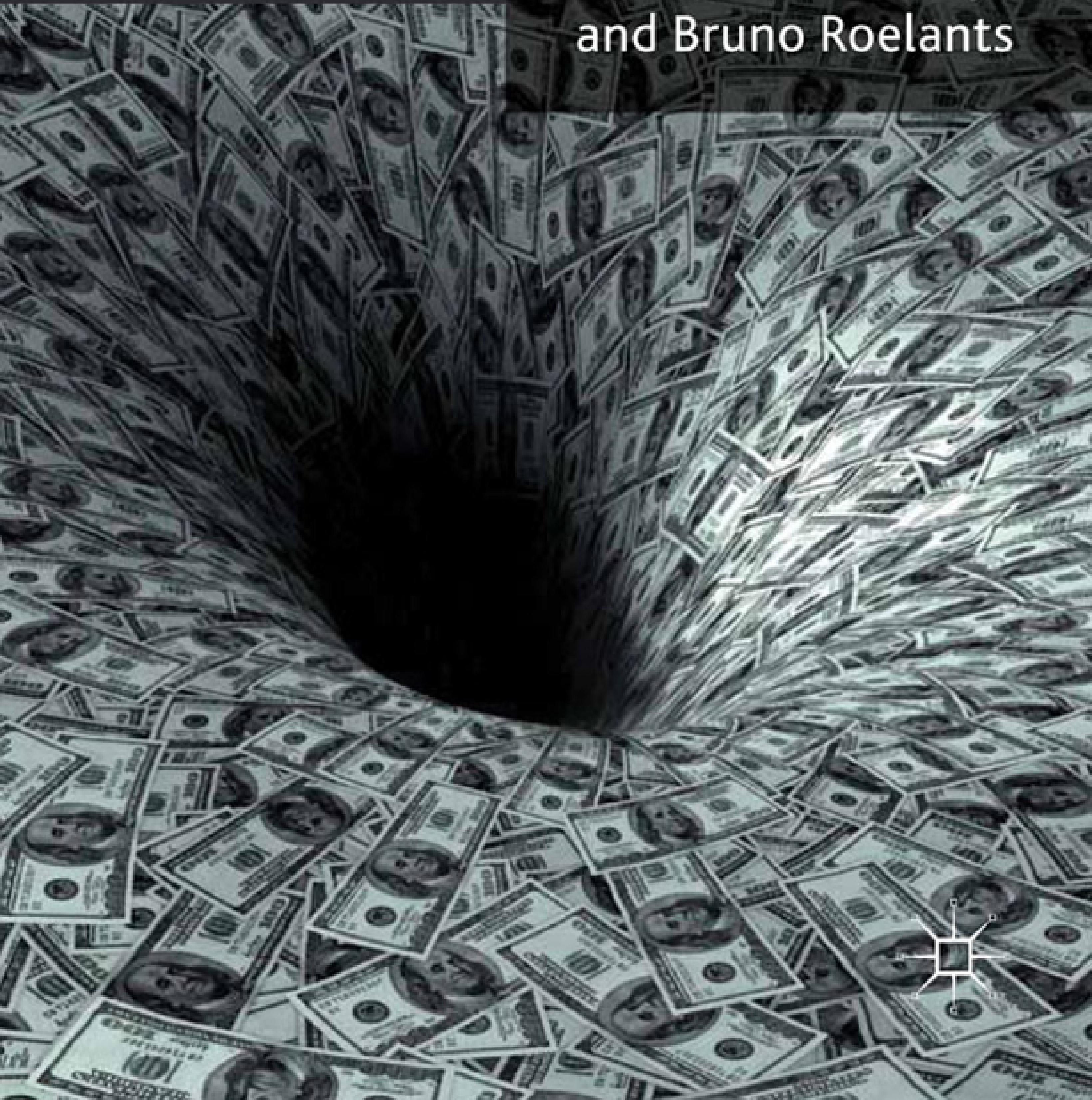
Capital and the Debt Trap

Learning from Cooperatives in the Global Crisis

Claudia Sanchez Bajo
and Bruno Roelants



Capital and the Debt Trap

This page intentionally left blank

Capital and the Debt Trap

Learning from Cooperatives in the Global Crisis

Claudia Sanchez Bajo

and

Bruno Roelants

Foreword by

Ian MacPherson

palgrave
macmillan

First published 2011 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

Palgrave® and Macmillan® are registered trademarks in the United States, the United Kingdom, Europe and other countries.

ISBN 978–0–230–25238–7

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data
Sanchez Bajo, Claudia B.
Capital and the debt trap: learning from cooperatives in the global crisis/Claudia Sanchez Bajo, Bruno Roelants.
p. cm.
Includes index.
Summary: "The financial crisis is destroying wealth but is also a remarkable opportunity to uncover the ways by which debt can be used to regulate the economic system. This book uses four case studies of cooperatives to give an in-depth analysis on how they have braved the crisis and continued to generate wealth"— Provided by publisher.
ISBN 978–0-230–25238–7 (hardback)
1. Cooperative societies—Finance—Case studies. 2. Debts, External—Case studies. I. Roelants, Bruno, 1954– II. Title.
HG4027.4.S26 2011
334—dc22 2011011735

10 9 8 7 6 5 4 3 2 1
20 19 18 17 16 15 14 13 12 11

Printed and bound in Great Britain by
CPI Antony Rowe, Chippenham and Eastbourne

Contents

List of Boxes, Figures and Tables

Boxes

Figures

Tables

Foreword

As a form of economic organization, the cooperative has been around for over two centuries. Today, it has been widely adopted within all major cultures and in virtually every country; the United Nations estimates that it helps approximately one half of the world's population meet at least one important need. People involved with cooperatives have engaged in lengthy and often fascinating discussions over their potential economic contributions, their underlying values and principles, and their operating practices and distinctive qualities. Because of these discussions, as well as the wide diversities in types of cooperatives and the varied contexts within which they exist, cooperatives can appear to be opaque – the great size of the movement unclear – in the popular mind.

Cooperatives and their movements have, in fact, not generally commanded the interest and respect they deserve. They are rarely discussed in general public discourse, even in places and in relation to issues where they could be particularly useful. They are almost entirely ignored in most academic circles, including those in countries where their contributions are obviously significant. They are typically undervalued in the development of public policy, though governments in different times, places, and situations have often found them useful. They have been frequently subjected to questionable, uninformed critiques and, even more seriously, marginalized and trivialized by pundits and advocates for capitalist firms. They have often been taken for granted or co-opted in countries where the state plays aggressive and domineering economic roles.

In contrast to this rather dismal and frustrating situation, this book presents a thoughtful and exciting consideration of the roles cooperatives can play – and should be expected to play – today. From among the many important dimensions that characterize the movement, five are arguably of particular importance. The first is the context within which it is cast. The book begins with a discussion of some of the current major issues confronting the world today and not with an 'internalist' discussion about cooperatives. It provides a strong and stimulating discussion of the financial breakdown of recent years. It examines what the authors consider are the key economic 'traps' of our times – in consumption practice, liquidity capacities, and debt accumulation. This discussion then becomes the context within which the cooperative model and options are then considered.

In other words, the authors' fundamental purpose is to discuss – realistically and precisely – how and why cooperatives should be seen as important players in the international economy today and not just as mere 'add-ons' when 'real business' for whatever reason is not fully effective. The authors do not fall into the trap, all too often evident among writers interested in cooperatives, of being satisfied with presenting pious declarations of the value of cooperation. The book is based on a well informed and carefully argued examination of the current global situation; an examination that in turn makes what they have to say about cooperatives particularly acute and useful.

At the same time, though, the second most obviously important feature of the book is the way in which the authors take seriously the underlying values and principles on which the cooperative movement and its institutions rest. They understand the fundamental importance of that exercise; they realize that the values and principles are central to cooperatives – they are not just inherited window dressing or a pursuit of market advantage in the age when 'social' business is fashionable. Ultimately, they are what makes the cooperative model particularly relevant in the modern era.

Third, the book provides a stimulating discussion of the importance of control over the economy. It describes the ways in which the current financial systems and short-term benefits for the few have shifted control, even in capitalist firms and within the global economy. It shows how that shift has distorted the 'real value' of what people produce and consume. This consideration leads invariably to a debate of the importance of 'control' within cooperatives. The very structure of the cooperative enterprise, which strives for forms of economic democracy, does provide a bed-rock for lodging control in the hands of key stakeholders, normally the consuming or producing members. Maintaining and refining that control, however, will always be a challenge, even in an age of expanding communication possibilities. It is a challenge that cooperators and cooperative organizations need to address constantly and more deeply. It is also a dimension of cooperation that the outside world needs to appreciate more fully.

Fourth, the book provides case studies of quite different types of cooperative organizations in four widely divergent circumstances in Mexico, France, Spain, and Québec. These cases demonstrate the variety of cooperative enterprise. They show differences in approaches, the importance of cultural and local circumstances, and the versatility of cooperative entrepreneurship. They provide much fruit for thought: they are about organizations responding to, and coping with, some of the most important economic and social changes of the times. They show why we need more such research, more inquiry in what might be called Cooperative Studies.

Finally, the book is particularly interesting because it addresses the 'big picture'. It looks at the commanding heights of economic and social change and not just at local accomplishments and victories. This is a refreshing, relatively uncommon, exception in the intensive literature of the cooperative movement. There is always a danger in cooperative writing and in the field of Cooperative Studies to be fascinated with the beginnings of cooperatives, with the successes achieved by small bands of people coping with adversity or seizing opportunities they individually could not grasp; with what one might call the 'Romance of Cooperation'. There is frequently a tendency, within and without the movement, to be suspicious of large organizations, with co-ops that become prominently and powerfully involved in the large economy.

This book is an imaginative and thoughtfully constructed exception to such trends. It dares to postulate the possible centrality of cooperative enterprise today and in the future. It joins with some other recent scholarship in exploring in a rigorous and tough-minded way what the current situation is and suggesting why and how the cooperative model is so important. It deserves to be widely read and discussed within and across the boundaries that have long divided cooperative proponents and the general public. It is an important opening statement, hopefully the first of many that will deepen celebrations of the United Nations Year of Cooperatives in 2012. It raises many of the issues that need to be discussed more fully; it provides a particularly useful framework within which those discussions can take place.

Ian MacPherson
Emeritus Professor of History
University of Victoria
Victoria, British Columbia, Canada

Acknowledgements

Our first acknowledgement goes to our mentors who have already left us: Professor Jorge Schvarzer, who was a PhD thesis examiner for Claudia Sanchez Bajo and supported her teaching project at Kassel University under the German DAAD programme; and Lu Guangmian, Que Bingguang and Yves Régis, who introduced Bruno Roelants to the world of cooperatives.

We then wish to thank the persons whose contributions and initiatives were fundamental in encouraging us to draft this book: first of all, Professor George Irvin at the School of Oriental and African Studies in London; Eva Nothomb and Amad Aminian who invited us to set up a conference on consumption trends at the Omar Khayam Cultural Centre in Brussels that served as the basis for the consumption trap section in Chapter 2 and the consumer function sub-section in Chapter 3; and former deputy regional director for Asia and the Pacific of the International Cooperative Alliance Rajiv Mehta for twice inviting Bruno Roelants to make presentations on cooperatives and the crisis at Asian meetings in 2008 and 2009. This provided us with very useful feedback from representatives from Asian governments and cooperative federations. We are also grateful to Jean Claude Detilleux, Jean-Louis Bancel and Etienne Pflimlin, whose views on the crisis, as key French cooperative bankers, were very helpful. Thanks to Imad Tabet and Marc Spiker for their precious information on the International Financial Reporting Standards and their evolution. We also thank all the anonymous reviewers' feedback during the process and Palgrave editor Taiba Batool for her faith in the project.

The persons who helped us with the empirical case studies deserve special gratitude: concerning the Natividad fishermen's cooperative in Mexico, president Esteban Fraire for the interview and all the information he provided us. For the Ceralep case, Michel Rohart, director of the Rhône-Alpes Regional Union of Worker Cooperatives in Lyon, for organizing all the interviews; Robert Nicaise, president of the cooperative for his warm welcome at the factory and his introduction to the various interviewees, first and foremost the workers; and Dominique Artaud for his accurate re-reading and correction of the chapter. For Desjardins, Ann Lavoie for introducing us to the various interviewees and resource persons; Alban D'amours for his patient re-reading and comments; and Pierre Poulin for all the material he sent us and for the re-reading and correction of all the historical information. For Mondragon, Mikel Lezamiz who helped identify the interviewees and organize the interviews; Adrian Zelaia for his advice and input; and Javier Salaberria for re-reading and correcting the chapter. We also wish to thank very warmly all the interviewed people in the four empirical cases, whose list can be found at the end of this book.

A number of persons provided us with invaluable information on cooperatives. On international sectoral issues, our thanks go to Rodrigo Gouveia and Thomas Van Zwol in the consumer/retail sector, David Rodger for cooperative housing and the whole CICOPA/CECOP staff for industrial and service cooperatives, especially for the two world surveys on the resilience of cooperatives to the crisis. At the national level, many thanks to Yoshiko Yamada for Japan, Hazel Corcoran for Canada, Tian Lihua for China, Antesh Kumar for India, Natasha Pruttskova for Russia, Joana Nogueira for Brazil, Mervyn Wilson for the UK, Caroline Naett and Gérard Leseul for France, Stefania Marcone for Italy, Paul Armbruster and Klaudia Marcus for Germany, and Carlos Lozano for Spain. We also wish to thank Claire Orts for her help in proofreading, and Maria Lopez de Verolo, Odile Van der Vaeren and Albert Carton for the stimulating discussions we have had with them. We are also grateful to our families and friends who encouraged us faithfully in this project.

The authors and publishers wish to thank the following for permission to reproduce copyright material: the Brookings Institution, the Department for Innovation and Skills of the UK Government, the Dow Jones, the EU Observer, the Daily Telegraph, the European Central Bank, the Financial Accounting Foundation, the Nobel Foundation and the United Nations Conference for Trade and Development (UNCTAD). Every effort has been made to trace rights holders, but if any have been inadvertently overlooked please contact the authors or the publisher.

Finally, we want to give our special thanks to the people of the village of Corezzo in the mountains of Tuscany in Italy, for their support in the very final stages of the drafting process and for their human gift in patience, endurance and wisdom.

CLAUDIA SANCHEZ BAJO
BRUNO ROELANTS

Introduction

What is happening to the global economy? How do we understand the global financial and economic crisis that was still wreaking havoc in the real economy in 2011? Even though we shall probably be discussing it for decades to come, the first explanations coming to mind are the 'sub-prime' housing mortgage crisis in the USA and financial firms that stopped lending to each other.

Following the fall of Lehman Brothers, the fourth biggest US bank, in September 2008, global panic flared up, spreading the crisis beyond the USA. To save the overall system, governments intervened generously, inflating state deficits along the way. While the financial system was saved, the real economy, firms, households and individuals, began to suffer the consequences of the credit crunch. Eventually, many nation-states have had to undergo a monetarist cure, restricting expenses and public services.

To most people, the crisis came as a surprise, as it had become commonplace to say that a new economy was in the making. A new order of things was to relegate economic cycles to the past. This new economy, highly financialized, thrived on structural state reforms, characterized by deregulation, privatization and liberalization policies, while the state rolled back its regulatory powers. Government became small while many key private economic entities, financial institutions and transnational companies (TNCs) in particular, became larger and larger. These policies were framed as part of 'neo-liberalism' or the 'Washington consensus'. Financial and economic globalization ensued, building highly interconnected global chains of finance, production and distribution. A 'lock in' of national reforms was expected, protecting states from ideological cleavages and political pressure. A 'free market' could finally evolve into an upbeat, unilinear and steady trend that would trickle down benefits over time.

In stark contrast, in September 2008, we were faced with an almost instantaneous collapse of financial and economic activity. Many crises in various countries and continents had occurred before but, this time, the highly interlinked globalized economy was overwhelmed in its entirety.

Raging debates about responsibility, guilt and punishment were unleashed. Who was responsible for the crisis? Were markets insufficiently regulated, driven towards speculation, including over-the-counter practices and handsome rewards? Was it because of individuals who took advantage of easy credit thanks to lax government policy? States allowing a high dispersion of regulators that lost their oversight capacity? Or perhaps, was it only the consequence of a few traders' greed? What was the recipe for disaster? The prevalent idea seems to be that banks are the ones to be restrained, while all actors should be 'moralized'.

In this book we explore the causes of this global crisis, delving into deeper layers of analysis (three mechanisms building traps and a shift in control patterns as the deepest cause), linking together the macro and the micro levels, the financial institutions and the real economy. Second, we bring forward inspirational elements drawn from the concrete experience of cooperatives and their resilience during the crisis, in the quest for solutions aimed at both preventing future crises and at creating general wealth.

Even though the whole world suffered the consequences of the financial and economic turmoil, this book centres attention on North America and Europe, as these two regions have been at the core of the crisis. Concerning developing and emerging countries, China receives special attention, given its key position in the world economy.

We will first review the timing of the crisis and its still lasting consequences, the extent of wealth destruction in its widest sense, the main issues addressed so far and the incipient strategies for recovery (Chapter 1).

We will then examine the various theoretical explanations that have been formulated on the crisis. While each explanation offers part of the truth, we propose a focus on three key mechanisms in the build-up of the crisis: a consumption trap, a liquidity trap and a debt trap (Chapter 2). These will help us analyse the in-depth causes of the crisis. From different standpoints, we have observed a pattern of debt practices that have led to an unsustainable financial and economic system. Debt practices have linked the financial and real economy together, and are an integral part of a financialized type of capitalism that appears to endanger capital and long-term wealth generation, as they lack a system of checks and balances. Of the three traps, the debt trap thus emerges as the most fundamental.

At an even deeper level, ongoing changes in the roles of producer, consumer and investor reflect an ongoing shift of boundaries between ownership and control in economic entities, together with the strengthening of global chains of production, distribution and finance (Chapter 3). The issue of control, conceptually distinguished from ownership, can then be connected to debt leveraged onto households and firms, linking the crisis, which is commonly regarded as a macro issue, to economic entities at the micro/meso-level.

We argue that the present complexity and interconnectedness of the global economy calls for new organizational patterns to ensure appropriate representation, transparency, timely information and trustworthy behaviour. Systemic risk is not only due to the fact that some economic entities may have become excessively large but also to the difficulty of setting limits to them, or providing opposing best practices, given that those same large entities are directly taking part in co-regulation with governments.

The extent of involvement and responsibility of very large economic entities has led to calls for a change in values: this is definitely very important, but such calls need to be translated into institutionalized practice, otherwise they will remain evanescent. Consequently, we need to rethink the organization of economic entities (banks, firms, etc.) and this global crisis may be a golden opportunity to do so. But where do we find the necessary inspiration? Amongst the many calls for reform, we hear a great deal about individual incentives and the 'too big to fail' debate. The discussion on control mechanisms against deviant behaviour tends to focus on the efficiency of external control and a change of incentives inside the firms, but ignores the key issue of institutional control mechanisms with proper checks and balances.

Among the diverse actors engaged in the economy, we observe that cooperatives, which are characterized by a specific type of control with checks and balances, have been surprisingly resilient to the crisis. In the second part of the book, we will bring to the fore their experience, by first drawing a general picture of their presence in the economy and society, their reactions and practices during the crisis, their underlying rationality, and their evolution from a political economy standpoint (Chapter 4). Then, in Chapters 5 to 8, we will visit four case studies, providing diversity in terms of sectors of the economy (financial services, industry, distribution, fisheries), size (from small and medium-sized enterprises [SMEs] to large business groups), history (from a few years to over a century) and geographical coverage among the parts of the world that are at the core of the crisis: Natividad in Mexico, Ceralep in France, Desjardins in Canada and Mondragon in Spain. We will argue in which way cooperatives can help us rethink the issue of control and steer clear of the debt trap.

More specifically, we will see that cooperatives offer a particularly interesting experience as they:

- are characterized by specific practices, including the systematic building of financial reserves;
- cater for the needs of key and numerically important stakeholders (for example, producers, consumers and users of services such as banking, social services, housing and energy), while being owned and controlled by these same stakeholders;
- always adopt a long-term perspective, do not delocalize, and have an interest in both economic growth and wealth generation;
- and have information flows among the owners–controllers, which tend to be more transparent and timely than those of average firms, providing legitimacy to decision-making and implementation.

In the final chapter, the book discusses which lessons from cooperatives may be useful in order to address the debt trap, in particular by re-equilibrating control in economic entities. We argue that, although many other measures will have to be carried out, this is a key part of the solution and will grow in importance as time goes by.

We decided to co-author this book by drawing on the respective knowledge and experience of both of us: Claudia Sanchez Bajo as political economy researcher and lecturer on globalization, regionalism, economic actors, production and distribution chains, and cooperatives; Bruno Roelants as specialist in development issues and engaged in the world of cooperatives at the European and world level.

At the time of completing this book, at the end of 2010, it was not yet clear whether this global crisis was receding or in a changing phase. Neoliberal-minded policy makers, after having resorted to massive bail-outs and even nationalisation of key large banks and firms, have returned to 'business-as-usual', with their previous structural reform policies. The causes of the crisis have not yet been sorted out. If we keep falling into the same traps, we may be faced with a new crisis that could destabilize the global economic system to the core, with grave political and social consequences. We argue that if we want to change the present trajectory, we need to become aware of the relationship between control and ownership, so as to to achieve the institutionalization of new values and practices that allow for a sustainable and long-term creation of general wealth.

We invite the reader to observe that, although the book was completed by the end of 2010, new events – some of them dramatic – are continuing to unfold along the lines of what we had written.

1
The Mother of All Crises?

Introduction

There is no doubt that we have been going through a grave global financial-economic crisis, but is this the mother of all crises? Without pretending to cover all aspects and leaving the explanations and analyses to Chapter 2, we here present the facts, as well as the perceptions and reactions of some key actors during the crisis up to the end of 2010. We are not, at this stage, making much reference to previous bubbles and crises, leaving the discussion for the following chapter. We are taking an inductive approach, as a necessary step before engaging in deeper layers of analysis.

When did it all start? For European Central Bank (ECB) President Jean-Claude Trichet, the turmoil started in August 2007.[1] For the Federal Reserve Bank-St Louis (Fed-St Louis),[2] it had begun on 27 February 2007 when Freddie Mac, in view of accounting changes, made the public announcement that it would stop its sub-prime lending mortgages in August 2007.[3] This letter was probably one of the 'butterflies' leading to the financial storm. In the next section, we review how the crisis began, then we observe signs of mounting trouble at the global level and, finally, we see how the global bubble burst.

Starting as a financial disaster, the crisis evolved into an economic one. Financial assets were wiped out, but the real economy was wounded as well. In the 'wealth destruction' section, we try to evaluate the scale of destruction that has occurred in various ways, not only in financial terms. Private sector credit contracted and had to confront the leverage of its debt obligations, namely the debt relative to assets or income, leading to a drastic downturn. Doubtless, the latter would have been far more dramatic without governmental intervention through rescue packages for banks and fiscal stimulus packages. An in-depth modelling study by Moody's chief economist Mark Zandi and Alan Blinder at Princeton University affirmed that, in the United States, these packages amounting to a total of $1.7 trillion had saved 8.5 million jobs and averted a further dip of 6.5 per cent in US economic output.[4]