

An Open Letter to Bellingham

From Michael H. Shuman¹

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Dear Residents,

I'm probably not the first person to tell you that your town is one of the most majestic places on Earth. The gorgeous ocean views, the surrounding forests, the cultural vitality, the salty humor and deep intelligence, all of this impresses the occasional visitor like me and clearly has convinced you proudly to make Bellingham your home. You've worked assiduously to protect your place, and you've understood – in a way so many U.S. communities have not – that a critical part of your future is honoring, nurturing, and expanding your local businesses. For people like me, who try to help communities across the country revitalize their economies, your efforts, spearheaded through Sustainable Connections and its Local First Campaign, constitutes a model of what needs to be done. And you should know that literally tens of thousands of people and businesses across America look up to you.

Here are some of the facts that have impressed me. Sustainable Connections now involves five hundred local businesses. You have a terrific “Buy Local Week” just before Thanksgiving that encourages Christmas shoppers to do their spending at local stores. Your buy-local coupon book, *Where the Locals Go*, is now in its fourth edition and features discounts from 160 member businesses. You've got a fabulous “Retail Kit” that arms local businesses with a window poster, a “Think Local First” decal, a “Tip Sheet for Making the Campaign a Success,” frequently asked questions and answers, a CD with monthly marketing materials, “The Top Ten Reasons to Think Local,” as well as a sheet of logos for public display and print advertisements. Your handbook, written by Michelle and Derek Long, *Think Local First: A How-To Manual*,² is being used by dozens of communities throughout North America.

Everyone is starting to notice. The former head of the local community foundation called Sustainable Connections one of the community's most important nonprofits. The

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² Michelle & Derek Long, *Think Local First: A How To Manual* (San Francisco: Business Alliance for Local Living Economies, 2005)

mayor of Bellingham considers it one of his most important economic development agencies. Governor Christine Gregoire says that she wants to see the Sustainable Connections' vision replicated across the state.

“Three years ago,” says John D’onofrio, owner of Northwest Computer, “being ‘local’ was a nonissue. Now there isn’t a day that goes by that someone doesn’t say they are supporting our business because we are local and that it is important to them. In the fifteen years that I have owned my business, I have found Sustainable Connections to be the most effect, most rewarding, and most cost-effective organization I have encountered.”³

As Local First gains ground in Bellingham and elsewhere, it also naturally attracts critics. Defenders of the existing economic order realize – quite rightly – that the principles, practices, and policies promoted by Local First depart dramatically from Jurassic-style economic development. That traditional approach is to retain or attract dinosaur-scale businesses that are believed to provide good jobs, and to develop clusters of globally competitive industries that can export a handful of world-class goods and services. While old-school economic developers concede that local small businesses are equally important, their vision of equality – in terms of interest, resources, and time – is akin to the equality of ingredients for elephant-mouse casserole: Add one elephant (big, nonlocal business) for every mouse (local business). The result, of course, is that elephant-mouse casserole tastes pretty much like pure elephant.

The guardian of old-style economic development in your area – and a frequent critic of Local First – is Dr. Hart Hodges, an assistant professor of economics at Western Washington College and director of its Business Development Program. Even though I’ve never met Hodges, I wound up meeting him virtually when a memo from him appeared in my e-mail inbox addressed to students at a course I was about to teach, with Stuart Cowan and Michelle Long, at the Bainbridge Graduate Institute. (See Appendix II.) Without knowing the content of the course, the syllabus, or the reading list, only that the topic was “local living economies,” Hodges warned our incoming students about professors “who try to make [economic development] simple by offering comforting claims and platitudes do more harm than good.”

I thought his memo made some good points, but its argumentative and condescending tone (not to mention the disparagements of myself and my fellow instructors) made it wholly inappropriate for the class. A better forum for this kind of discussion, I suggested, might be a public debate. A negotiation about the specifics of a debate ensued, in which I ultimately said I would agree to any topic, in any format, as long as it was just the two of us with audience participation. Hodges turned me down.⁴ I’m not going to dwell on this history. It’s water under the bridge. But I do want to share in writing what I had hoped to raise in the

³ Ibid.

⁴ In fairness, Hodges was willing to participate in a multi-speaker conference, in which he could bring his departmental allies to bolster his views and reduce my own air time. I declined. My offer to engage Hodges in a public, Lincoln-Douglas debate remains open, when he’s up to it.

debate, for the stakes in Bellingham are too high to let his criticisms of Local First go unanswered.

Let me begin by saying that there are many parts of Hodges' views I respect. He seems to care about the environment, local businesses, and the health of Bellingham. He spends lots of time with his students and his colleagues. He's intelligent, well read, articulate. He's probably a good father and a good neighbor. He asks hard questions, because he sincerely believes these will help Bellingham. All these character traits are what have made him someone who deserves to have his opinions heard and engaged with.

But Hodges is not a neutral observer. He insists, to be sure, that his opinions are not really his own but widely accepted gospel of his (and my) profession of economics. The implicit message, like what Dr. Peter Venkman (Bill Murray) yells at the Mayor of New York in *Ghostbusters*, "Back off man. I'm a scientist!" Hodges may be a scientist of sorts, but his views turn out to be the stale and largely discredited theories that many more forward-looking economists and economic developers are discarding. You, the custodians of the future of Bellingham, need to know the ways in which his views are out of touch with cutting-edge thinking about community development and how, were they followed, they would undermine the very things you care so much about.

Hodges's Worldview

Discovering just what Hodges's views are, I must admit, is no easy task. For him to know my views, in contrast, requires only a visit to the public library. I've written a widely used book on the subject of community development (the second one, *The Small-Mart Revolution: How Local Businesses Are Beating the Global Competition*, is out in June), and dozens of articles in popular newspapers, magazines, and journals. His online resume, in contrast, lists two articles – one in an obscure health policy journal, and the other a co-authorship many years back in a popular left-liberal magazine called the *American Prospect*.⁵ Neither of these concerns community economics, and he has written no books on the subject, only a few op-eds in the local papers. (See, e.g., Appendix III.)

Those of you who take the time, as I have, to read these writings, plus his other e-mails and memos, still must puzzle over what he believes and advocates. Hodges rarely writes positively and programmatically. He asks questions, sometimes friendly, sometimes hostile, but almost never answers them himself. He picks things apart, but has little inclination to put them back together. He demands data, but usually supplies anecdotes. He pushes for peer review of studies being cited, and yet hasn't offered any of his critiques in a peer-reviewed form.

Trying to find a coherent worldview in this is difficult but here's what I think we know:

- Hodges wants a local economy to be sustainable and prosperous, but believes there's little connection between local ownership and these objectives.

⁵ http://www.northerneconomics.com/harth_resume.html .

- He believes that a strong local business sector is important for Bellingham's prosperity, and that's why, apparently, he sometimes buys local himself. But he believes that equally important are nonlocal firms that provide well-paying jobs to workers and chain stores that sell affordable goods to consumers.
- In his view, prioritizing local business – a fundamental tenet of Local First – harms workers because local businesses tend to pay lower wages, and harms consumers because the locals charge higher prices. By denying the citizens of Bellingham the extra money that would come from nonlocal jobs and nonlocal products and services, Local First is robbing community wealth that could be used, among other things, to improve environmental and labor standards.
- Local First, moreover, violates a hundred years of theoretical economic thinking about comparative advantage. Buying local is a barrier to the free exchange of goods and services that might otherwise serve Bellingham.
- Recent studies that suggest that expenditures in local business contribute more to the economic well-being of a community than nonlocal business, such as those by a consulting firm called Civic Economics, are not grounded in sound economics, have not been peer reviewed, and should not be used as a basis for policymaking.

Is this fair? Just to be sure, I e-mailed Hodges to clarify what his viewpoint on economic development was. He responded: "I am not promoting a particular view on economic development (my views are consistent with the International Economic Development Council definitions and views) or suggesting that any one type of business is better than another."

This response is typical. His views – still undefined – are consistent with IEDC, a professional society of economic developers. Can you imagine being a patient in a doctor's office, asking what course of treatment he might offer, and his responding that you have no need to know except that his efforts will be consistent with those recommended by the American Medical Association? Most patients, fearing malpractice, would flee the doctor's office as fast as they could.

Okay, there's more. He's not "suggesting that any one type of business is better than another." All businesses are equal: big and small, local and nonlocal, honest and dishonest, clean and dirty, generous and stingy. So this is his formula for sustainability? For local prosperity? Believe it or not, this *is* the view of most economic developers in the United States, that all businesses are created equal – with the result, of course, being elephant-mouse casserole.

It's a self-defeating perspective. If the economic development department is indifferent to the environmental performance of a given business it's attracting or supporting how can it possibly claim to be promoting sustainability?

Moreover, the superficial even-handedness of economic developers is antithetical to one of the most basic challenge in economics – managing scarcity. There are limited economic development resources in Bellingham—limited people, limited hours, limited attention. These cannot possibly be focused on all businesses equally. Hard choices need to be made. And to succeed, economic development must make those choices with some coherent theory. In the absence of thoughtful priorities, economic developers like Hodges are proceeding in Brownian motion, likely making poor choices that serve no one particularly well.

The Virtues of Local Business

My contention is that a community should put out the welcome mat for many different kinds of businesses – though not dirty or unethical ones – but only offer systematic support only for locally owned ones. That’s where a community’s scarce people, hours, and attention should go. And that’s the position of Local First. There’s a vast and expanding literature, both popular and academic, that locally owned businesses are consistent with multiple community goals. The footnotes I’m about to drop here are only meant to be suggestive of this literature, not exhaustive, primarily to highlight that there *is* a literature. I do this to highlight that Hodges’s periodic assertions that his views represent a consensus position in the hard sciences of economics and economic development are simply untrue.

To summarize ten of these arguments:

(1) *Higher Standards* – The most fundamental difference between local and nonlocal businesses is that the former stick around while the latter may well move to Mexico or Malaysia. Consequently, any community seeking sustainability through nonlocal businesses, in the final analysis, cannot possibly do so, because those businesses are leading the fights against tougher environmental standards.⁶ A good example of this is in my backyard, Maryland. Regulation of the chicken industry has been virtually impossible because the producers, Tyson and Perdue, are continually threatening to move to “business friendly” jurisdictions like Arkansas and Mississippi. This same problem also afflicts economic development that seeks higher wages through nonlocal industry. Yes, they may pay better, but they often fight higher labor standards for all business.

(2) *Greater Wealth* – Because nonlocal businesses come and go while local businesses more often stick around for years, even generations, they are much more reliable generators of wealth, income, and jobs. Around the country, economic developers have offered millions of dollars of incentives to attract or retain nonlocal business, and by and large these deals have been huge losers.⁷ Not because these industries didn’t have great performance on paper, including the promise of high wages. But because they stayed for a couple of years, took the incentives, and then vanished. There are some 300 empty Wal-

⁶ See generally Thomas Michael Power, *Environmental Protection and Economic Well-Being* (Armonk, NY: M. A. Sharpe, 1996). Power is chair of the economics department at the University of Montana.

⁷ Alan Peters and Peter Fisher, “The Failures of Economic Development Incentives,” *Journal of the American Planning Association*, 70, no. 1 (Winter 2004): 28.

Marts for example across the country – each continuing to cause environmental problems from runoff and the like – that stand as testaments to the economic developers who thought they could lure the box stores for more than a heartbeat. The comings and goings of the supposedly high quality jobs turn out to be a very poor bargain for public expenditures on economic development. According to an investigative report about the cost effectiveness of tax abatements in Lane County, Oregon, the cost to the community in lost taxes was about \$23,800 per job for nonlocal firms and \$2,100 per job for the local firms.⁸ The nonlocal jobs were *more than ten times* more expensive, because the absentee-owned firms were so unreliable. On a net jobs basis (after the big departures), nonlocal jobs were 33 times more expensive.

(3) *Greater Stability* – The comings and goings of large, nonlocal business create enormous stresses, especially on a small community’s economy. In the Katahdin Region of Maine, where I’ve been working over the past few years, the shutdown of a paper mill (the parent company sought to move operations to a lower-wage area) created a regional unemployment rate of 40% over the next year. That kind of catastrophe is far less likely in a community economy built primarily around local businesses with no plans for moving to China.

(4) *Greater Multipliers* – There’s a growing body of evidence that local businesses contribute more to local multipliers – the most fundamental basis for community income, wealth, and jobs. I’ll say more about this point shortly.

(5) *Less Vulnerability* – A local economy that is more self-reliant will be more immune to global surprises totally outside its control. The obvious example right now is importation of oil, which many observers link with terrorism and economic instability and which could be largely eliminated through the cost-effective implementation of local energy efficiency and renewable resources over the next generation.⁹ Importing food is another example, in that it leaves a community vulnerable to imported pollution, micro-organisms, and pests from less responsible farmers elsewhere in the world.

(6) *Smart Growth* – Local small business is a natural promoter of “smart growth” or anti-sprawl policies. Smart growth means redesigning a community so that residents can walk or ride bikes from home to school, from work to the grocery store. It means scrapping old zoning laws and promoting multiple uses—residential, commercial, clean industrial, educational, civic—in existing spaces, because it’s better to fully use the town center than to build subdivisions on green spaces on the periphery. Because local businesses tend to be small, they can fit more easily inside homes or on the ground floor of apartment buildings. Because they focus primarily on local markets, local businesses place a high premium on being easily accessible by local residents.

⁸ Sherri Buri McDonald and Christian Wihtol, “Small Businesses: The Success Story,” *The Register-Guard*, 10 August 2003.

⁹ Amory B. Lovins et al., *Winning the Oil Endgame: Innovation for Profits, Jobs, and Security* (Snowmass, CO: Rocky Mountain Institute, 2004).

(7) *Greater Identity* – Part of what makes any community great is how well it preserves its unique culture, foods, ecology, architecture, history, music, and art. Local businesses celebrate these features, while nonlocals steamroll them with retail monocultures. Outsider-owned firms take what they can from local assets and move on. It's the homegrown entrepreneurs whose time horizon extends even beyond their grandchildren and who have a vested interest in growing these assets. And it's the local firms who are most inclined to serve local tastes with specific microbrews and clothing lines. Austin's small business network employs the slogan "Keep Austin Weird," because it's "weirdness" that attracts tourists, engages locals in their culture, draws talented newcomers, and keeps young people hanging around.

(8) *Greater Creativity* – Richard Florida's arguments about the importance of a "creative class" for economic success also tend to support locally owned businesses.¹⁰ Florida argues that among the key inducements for a creative class to move to and stay in a community are its civic culture, its intellectual bent, its diversity, and its sense of self—all attributes that are clearly enhanced in a local-business economy. A local-business economy seeks to celebrate its own culture, not to import mass culture through boring chain restaurants and Cineplexes. It seeks to have more residents engaged as entrepreneurs and fewer as worker bees for a Honda plant. Myriad ideas and elements of a culture can best emerge through myriad homegrown enterprises.

(9) *Greater Social Well Being* – In 1946 two noted social scientists, C. Wright Mills and Melville Ulmer, compared communities dominated by at least one large manufacturer versus those with many small businesses.¹¹ They found that small business communities "provided for their residents a considerably more balanced economic life than did big business cities" and that "the general level of civic welfare was appreciably higher." Thomas Lyson, a professor of rural sociology at Cornell University, updated this study by looking at 226 manufacturing-dependent counties in the United States.¹² He concluded that these communities are "vulnerable to greater inequality, lower levels of welfare, and increased rates of social disruption than localities where the economy is more diversified."¹³

(10) *Greater Political Participation* – Studies of voting behavior suggest that the longer residents live in a community, the more likely they are to vote, and that economically diverse communities have higher participation rates in local politics. Moreover, Harvard

¹⁰ Richard Florida, *The Rise of the Creative Class* (New York: Basic Books, 2002).

¹¹ C. Wright Mills and Melville Ulmer, "Small Business and Civic Welfare," in *Report of the Smaller War Plants Corporation to the Special Committee to Study Problems of American Small Business*, Document 135. U.S. Senate, 79th Congress, 2nd session, February 13. (Washington, DC: U.S. Government Printing Office, 1946)

¹² Thomas A. Lyson, "Big Business and Community Welfare: Revisiting A Classic Study," monograph (Cornell University Department of Rural Sociology, Ithaca, NY, 2001): 3. Journal publication of this piece, with updated data, will occur shortly.

¹³ *Ibid.*, 14.

political scientist Robert Putnam has identified the long-term relationships in stable communities as facilitating the kinds of civic institutions—schools, churches, charities, fraternal leagues, business clubs—that are essential for economic success.¹⁴ As one group of scholars recently concluded after reviewing the social science literature: “[T]he degree to which the economic underpinnings of local communities can be stabilized—or not—will be inextricably linked with the quality of American democracy in the coming century.”¹⁵ An economy with many long-term homegrown businesses is more likely to contribute to such stability than the boom-and-bust economy created by place-hopping corporations.

What does Hodges have to say about all these studies and arguments? Well, nothing, except on point 5, about multipliers. Okay, he does raise issues about the labor benefits of point one, though he never weighs the higher wages of larger firms against the greater mobility and unreliability of these jobs. We’ll explore these two arguments in a moment.

On the other eight points, a good scholar might carefully read these studies, ponder their implications, weigh all these facts, and probably conclude that there are at least some plausible reasons why we should favor local business. That Hodges focuses so consistently and exclusively on the alleged down sides of local business and thinks that further discussion is intellectually closed underscores, that in the end, he’s really not a scholar on these issues at all, but an advocate.

Advocacy, I want to be clear, doesn’t trouble me. I’m proud to say that I’m an advocate who supports small local businesses and small communities. What bothers me about Hodges’s advocacy are the pretensions of neutrality and his efforts to cut off discussion by claiming his credentials should trump his opponent’s views.

So let me clarify: Hart Hodges’ advocacy against Local First, against buy-local campaigns, and against local business is identical to that practiced by big-business and big-box-store advocates around the country. But it is increasingly out of step with economic and community developers who have come to see the sense in prioritizing support for local business.

Even the *Primer* for Hodge’s Mothership, the International Economic Development Council, has a greater appreciation for local businesses than he has: “[Small businesses] are set apart from larger companies in a number of ways. First, they are typically more innovative in terms of products and processes. Second, they are less likely to relocate because of strong community ties, and are more likely to hire local residents. Third, research has found that small businesses that are able to survive the first few critical years have profit margins as strong as, if not stronger than, large corporations. Finally, small businesses are much more flexible than large ones which means they can adapt to changes in market demand faster.”¹⁶

¹⁴ Robert Putnam, *Making Democracy Work* (Princeton: Princeton University Press, 1993).

¹⁵ Thad Williamson, David Imbroscio, and Gar Alperovitz, *Making A Place for Community: Local Democracy in a Global Era* (New York: Routledge, 2003), 8.

One reason I suspect Hodges doesn't deal with eight out of ten of the arguments for Local First is that they arise from fields other than his own. Some come from sociology, some from political science, some from public policy, some from law, and some from philosophy. A scholarly approach to economic development, I believe, has to draw from myriad fields. But I am happy to narrow the discussion to the only field where Hodges seems comfortable – namely economics.

Multipliers

One of the compelling arguments for buying local is that every local purchase has a greater multiplier effect. Each purchase you make triggers purchases by others. For instance, a dollar spent on rent might be spent again by your property owner at your local grocer, who in turn pays an employee, who then buys a movie ticket. The more times a dollar circulates within a defined geographic area and the faster it circulates without leaving that area, the more income, wealth, and jobs it generates. This concept, which is arguably the foundation of community economics, points to the importance of maximizing the number of dollars entering a community and minimizing their subsequent departure.

The multiplier obviously diminishes with geographic distance. The farther from home you go to make a purchase, the less of the multiplier comes back and touches your community. Buy a radio down the block, the multiplier is high; buy it ten miles away, the multiplier weakens; buy it mail order, and your community gets practically no multiplier whatsoever.

There is one boundary beyond which part of the multiplier drops precipitously—that of a tax jurisdiction. A rough definition of “local,” then, might be the smallest jurisdiction with real tax authority. For some this will be a town, for others it will be a city or a county. And since every purchase leads to a variety of taxes—sales taxes, wage taxes, property taxes, and business taxes—making a purchase even one village over can significantly diminish the taxes that might have gone to your own local government.

A number of studies in recent years have suggested that every dollar spent at a local business has a much higher impact than a dollar spent at a nonlocal business. In the summer of 2003, for example, a group of economists at Civic Economics studied the impact of a proposed Borders bookstore in Austin, Texas, compared with two local bookstores.¹⁷ They found that one hundred dollars spent at the Borders would circulate thirteen dollars in the Austin economy, while the same one hundred dollars spent at the two local bookstores would circulate forty-five dollars—roughly three times the economic benefits. In 2004 Civic

¹⁶ Beth Van-Spanje, “What Is Economic Development: A Primer” (National Council for Urban Economic Development, Washington, DC, 1996), 14. Since this was published, the National Council has merged with another organization and been renamed the International Economic Development Council.

¹⁷ The Austin study is “Economic Impact Analysis: A Case Study,” monograph (Civic Economics, Austin, Texas, December 2002). The Andersonville study is “The Andersonville Study of Retail Economics (Civic Economics, Austin, Texas, October 2004). Both can be downloaded for free as www.civiceconomics.com.

Economics completed another study of Andersonville, a neighborhood in Chicago. The principal finding was that a dollar spent at a local restaurant had 25 percent more economic impact than a chain. The local advantage was 63 percent more for local retail, and 90 percent more for local services. Other studies by Civic Economics are now in progress.

The ground-breaking work of Civic Economics hardly stands alone. A study of eight local businesses in the towns of Rockland, Camden, and Belfast found that they spent 45 percent of their revenue within their local counties, and another 9 percent statewide.¹⁸ The aggregate level of in-state spending was nearly four times greater than that from a typical chain store. Other studies in the United States and abroad also have found that local businesses yield two to four times the multiplier benefit as comparable nonlocal businesses.¹⁹

Hodges rejects these results. His complaints? These studies haven't been peer reviewed. He doesn't find the expenditure numbers of the stores studied believable. And the "fact" that consumers must spend more money for local goods and services is not taken into account. Let's look at each of these, though I invite the reader also to read the appended response of one of Civic Economics' principals, Dan Houston. (See Appendix I.)

"No peer review" is a common refrain from Hodges. But under closer scrutiny, it turns out to be an example of critiquing through innuendo rather than through analysis, and a way of discouraging people from thinking independently. If formally peer-reviewed studies were the only documents we could cite, most economic policy debates would be pretty boring, sterile, and uniformed. (A huge percentage of the academic economics literature is purely theoretical and mathematical.²⁰)

Three quick points about Hodges's demands for peer review. First, nothing he has done critiquing Local First remotely meets the standard, so if we apply the Hodges standards to Hodges, we should ignore what he says. Second, he's inconsistent – the few studies he marshals to support his own positions (see below) are not peer reviewed. Third, he appears confused about the meaning of term. In his resume, he calls his own *American Prospect* article peer reviewed, when in fact, it's a popular magazine that "peer reviews" largely with undergraduate interns.

¹⁸ "The Economic Impact of Locally Owned Businesses vs. Chains: A Case Study in Midcoast Maine," monograph (Institute for Local Self-Reliance and Friends of Midcoast Maine, September 2003).

¹⁹ See, for example: David Morris, *The New City-States* (Washington, DC: Institute for Local Self-Reliance, 1982), p. 6 (showing that two thirds of McDonald's revenues leak out of a community); Christopher Gunn and Hazel Dayton Gunn, *Reclaiming Capital: Democratic Initiatives and Community Control* (Ithaca, NY: Cornell University Press, 1991) (finding that 77% of a typical McDonald's "social surplus" leaves the community); Gbenga Ajilore, "Toledo-Lucas County Merchant Study," monograph (Toledo, OH: Urban Affairs Center, 21 June 2004)(calculating an economic impact of a local bookstore more than four times greater than that of a typical Barnes & Noble); Justin Sachs, *The Money Trail* (London: New Economics Foundation, 2002) (spelling out a multiplier methodology used by communities throughout the United Kingdom, and documenting case studies showing how local businesses double or triple the economic impact of nonlocal competitors).

²⁰ Peter Monaghan, "Taking on 'Rational Man'," *Chronicle of Higher Education*, 24 January 2003.

I want to be clear: There is value in having scholars and experts review one another's work, especially in a double-blind way, prior to publication. But it's also an archaic system, filled with flaws, bias, old boy networks, and one that even academics and scientists are having second thoughts about. Most importantly, peer review can be carried out in many different ways. I've had two dozen people read each of my book manuscripts prior to publication, including economists and economic developers hostile to my ideas. Civic Economics also has had a number of economists and economic developers review their studies prior to publication. One of the peer reviewers of the Andersonville study, for example, was me.

Let's move on to the substance.

What these multiplier studies are telling us is pretty obvious: *Local businesses spend more money locally*. In the Austin analysis, local bookstores, unlike Borders, have local management, use more local business services, advertise locally, and enjoy profits locally. These four items alone can easily constitute a quarter or more of a business's total expenditures. When any business spends more of a given purchasing dollar locally, it almost always has a higher multiplier impact. That's why economic developers are so enthusiastic about "clusters" of businesses, because the local purchasing streams of these businesses reinforce one another and strengthen all the linked businesses.

The economic models that are widely used to measure multiplier impacts, like IMPLAN and RIMS-II, are really measuring the density of these local linkages. Their algorithms, however, are developed from very aggregate data (much of it national). They show, for example, how likely it is that the *average* filling station spends money locally, and what the impacts of those secondary purchases are. All these averages represent aggregates of local and nonlocal businesses. Discovering the specific expenditures of a business, therefore, necessarily *improves* meaningful use of the models. And what Civic Economics has done is find similar local and nonlocal businesses – bookstores, restaurants, etc. – and then compare their local expenditures.

I am aware of dozens of studies that show, generally speaking, that local businesses spend much more money locally than do similar nonlocal businesses. I'm not aware of a single study, peer reviewed or otherwise, which has found the opposite. I welcome Hodges to cite one.

As Dan Houston writes in a rejoinder to Hodges, "We had the opportunity to sit down with cooperating business owners, open the books, and follow each dollar of revenue that enters the firm. For the independent businesses we have studied, we have absolute faith in those numbers. As to the chain businesses, which did not cooperate in these studies, we used corporate averages for all numbers, in all cases liberally crediting chains with local spending. Hodges can speculate on cost of goods, labor, etc. until the cows come home; we actually did the legwork to get those values."

The final complaint Hodges has about the numbers is that they should show that consumers at local businesses are spending more than they are at nonlocal businesses. In

fact, however, we shall see that it's not reasonable to make *any* assumptions about whether local or nonlocal businesses offer better deals. Put another way, Civic Economics' methodology is far sounder than Hodges' proposed adjustments. More on this shortly.

The Wages of Local First

The second nugget of an economic argument against local business I've been able to extract from Hodges's writings is a concern about their wages. "In my research I've found job growth to be very spatially dependent and wage growth to be positively correlated with firm size." But, he adds, "One thing I notice in my work is that the positive correlation between firm size and wages is not impressive. That is, bigger is better when you control for other important factors and are careful with the statistics... but the effect is quite small."

So what's the big deal?

For more than a generation researchers have found what Hodges has found – that is, evidence that businesses with more than five hundred employees pay slightly more on average than businesses with fewer than five hundred employees. But one recent statistical analysis of the relevant academic literature found that between 1988 and 2003 these differences, in both wages and benefits, shrank by about a third.²¹ If this trend continues—especially as many of the once high-paying larger firms continue to move factories overseas and as low-wage retailers like Wal-Mart continue to displace existing small business—these differences could disappear altogether.

Large businesses that once offered fabulous worker benefits are now chopping them away, as more and more managers struggle to contain ballooning health care costs and dump responsibility for pension contributions directly on the employee. The growing incidence of big firms declaring bankruptcy (including United Airlines, a company controlled by its own workforce) as a strategy to escape long-standing health plans and pension benefits should give pause to anyone who thinks that big business is the ticket to economic security. The real solutions for *all* Americans to have better health care and retirement—not just those employed or employable—must come, as they do in almost every other industrialized country, from smarter public policy.

Small businesses may be less easy to unionize than large ones, but that doesn't necessarily make them less sensitive to labor rights. Some of the most socially responsible entrepreneurs in this country are the small business pioneers who are members of organizations like Sustainable Connections and the Business Alliance for Local Living Economies (BALLE) who believe that high wages and decent benefits are not just good motivators but also moral imperatives. The closeness of the relationships between the people on the top and the bottom of these small firms also can be a powerful force for empathetic management. And it seems ludicrous for labor to favor big businesses when nearly all of

²¹ Matissa N. Hollister, "Does Firm Size Matter Anymore? The New Economy and Firm Size Wage Effects," *American Sociological Review* 69 (October 2004): 659–76.

them, by now, cannot wait to purge their businesses of unions by moving production overseas.

Sooner or later, the labor movement in the United States will recognize that large-scale enterprises have become dead ends for vindicating the rights of workers. Labor should embrace small business, unionize it where it can, and encourage worker ownership, participation, and entrepreneurship where it can't. Meanwhile, higher community standards through living wages and serious health care reform are probably the most effective ways of helping all workers, irrespective of the size of their employer. That Hodges opposes living wages only deepens suspicions that his commitment to labor rights is lukewarm at best.

The Competitive Price of Hodges' Balls

The core argument that Hodges wields against Local First is the assertion – little more – that local businesses charge higher prices, and that's why any economic development prioritizing local business is such a bad deal. Here's a typical Hodges fact: "A can of tennis balls at the Sportsman Chalet costs \$3.50. The price is \$3.25 at the Bellingham Tennis Club. Both are local businesses. The same balls cost \$1.99 at Big-5 and Wal-Mart. If I spend the extra money at the locally owned stores, I am not really helping the local economy."

But Local *First* does not demand that Hodges or anyone should be spending more money on anything. It encourages, instead, that Hodges ask some of the following questions before getting his tennis balls at Wal-Mart:

- If I can get the balls at the local store quickly but have to drive a hour to the Wal-Mart, what are the transaction costs for my time and driving? How does that affect the deal I'm about to get.
- How do I factor that Wal-Mart usually contracts with name-brand companies to produce shoddier products that won't last as long or perform as well? What happens, in other words, when what seemed like identical goods turn out to be inferior?
- A number of states have recently found that Wal-Mart is systematically overcharging its customers 8 percent of the time and are launching criminal investigations. If an overcharge sneaks past me at the register, how does that affect my savings?

So, to the question about which tennis balls are cheapest, there is rarely a simple answer. And this is about a product that is identical or close to identical from store to store – the kinds of goods economists say are "substitutable." For most purchases, the differences among options are more subtle and the alternatives are tougher to compare. How do you weigh a high-powered Seattle attorney who charges \$250 per hour to a less well known Bellingham attorney who charges \$100 per hour but is someone who is accessible, diligent, and trustworthy? How do you compare a cheap vacuum from Wal-Mart from a brand you never heard of to a more expensive brand you know at a local appliance store? How do you

compare non-organic tomatoes at Albertsons with more expensive organic alternatives at your local Farmers' Market?

I don't want to pretend I have a good answer to these questions, but neither should Hodges. *There is no objectively valid answer to most of them.* It depends on the "tastes" of every consumer, and for most consumers these will vary enormously. That Local First encourages consumers to ask these questions – to think carefully about the issues implicated, to provide them with the best information possible about their quality and price and origin – should be applauded, not castigated. Economists assume perfect information, while Local First actually works to achieve it.

Are Wal-Mart's Prices *Always* Cheaper?

Back to Hodges's example: Can we say that generally Wal-Mart typically offers cheaper prices than local retailers for a good like tennis balls, and that Local First requires consumers who face those rare identical goods to pay a "price premium"? Well, no. A 2002 survey by the Maine Department of Human Services, for example, found that local drugstores actually provided better deals on identical generics than the pharmacies at Rite Aide and CVS.²² Wal-Mart prescription prices fell roughly in the middle of the group surveyed. In this case, it's chain store shoppers who have to pay a "price premium."

The only additional evidence that Hodges cites that suggests that Wal-Mart offers cheaper prices is a recent study from Global Impact. Here Hodges is embracing Wal-Mart's own PR, which turns out to be as shoddy as most of its goods. Wal-Mart's web site boasts, "Global Insight, an independent economic analysis firm, concluded that Wal-Mart saved working families over \$2,300 per household last year."²³ Just this one factoid – repeated uncritically in op-ed pages across America – is a classic case of misrepresentation by the corporate giant.

Even taking the Global Insight study at face value, the *net* savings per household – after accounting for Wal-Mart's reductions – is \$1,046, less than half the number Wal-Mart cites.²⁴ But the deception turns out to be greater, because Global Insight is making claims for the *average* household in the United States. It duly notes that consumer expenditures totaled \$8.2 trillion, and that Wal-Mart's prices saved 113 million households \$263 billion. The annual consumption for an average household is \$73,000. *Median* household consumption – that is, the level below which half of all households are at – is about \$44,000. For the lower half of all U.S. households, the "working" families who are the main customers at Wal-Mart, the average savings are under \$630 per year. Wal-Mart's web site thus overstates its case four-fold.

²² "Maine Drug Pricing Survey—2002," Maine Department of Public Health, Bureau of Elder and Adult Services.

²³ See www.walmartfacts.com/community.

²⁴ "The Economic Impact of Wal-Mart," monograph (Global Insight, 2 November 2005): 18.

Whether the Global Insight study is credible is another question. Its economic model is proprietary and its assumptions cannot be reviewed (peer or otherwise). One underlying assumption that seems particularly dubious is that many of the efficiency gains in retail over the past 15 years would never have occurred but for Wal-Mart. In fact, Wal-Mart is continuously learning from other retailers and vice-versa.

Global Insight also never grapples with the direct costs of displaced small retailers, nor the lost community multiplier benefits when these high-multiplier retailers are replaced by low-multiplier Wal-Marts. If Wal-Mart generates half the multiplier benefits of the stores it displaced – and that might be a very generous assumption -- the \$1,046 saved by a household could cost the same household as much or more in terms of lost community income, wealth, jobs, and taxes.

Does Hodges discuss any of these weaknesses of the study? Does he reveal that it was commissioned by Wal-Mart? Does he care about the implications for scholarship? Does he suggest that we should take the results with a bunch of caveats? Does he question the integrity of the scholars? Does he express concern that *this study* has not undergone peer review? These are the lines of attack Hodges applies to studies friendly to Local First, and it seems telling that he doesn't apply equivalent scrutiny to a pro-Wal-Mart study.

The Real Competitiveness of Local Business

I don't want to pretend that Wal-Mart and other chain stores don't have some great deals, some of the time. Of course they do. But that says nothing about the overall competitiveness of local business across millions of goods and services. Here are some of the inconvenient facts that generalizations about the supposed uncompetitiveness of local business overlook:

- Half of the competitive private-sector economy (and 58% of the entire economy) is made up of economic entities that are rooted in a local place. Only a minority of the competitive economy turns out to be big and absentee owned.
- Retail, where local businesses have indeed lost ground in recent years, represents about seven percent of the economy, and chain stores about half of all retail. What about the other 93% of the economy? In other sectors, local businesses have made many significant inroads against the nonlocals. Investment advising for trusts and estates has gone local. Mini-mills for steelmaking are doing well. Utilities are shrinking in size. Even as some textile, clothing, and transportation equipment manufacturing moves overseas, smaller plants in these sectors are expanding.
- Many local expenditures clearly save money. Spending more on local energy efficiency instead of nonlocal oil or electricity is a prime example. Spending locally on local therapy, family support, exercise, and nutrition prevents greater expenditures on nonlocal pharmaceuticals. Using mass transit, bicycles, and your own two feet more similarly supports the local economy and saves money.

- Some expenditures that are purely discretionary can be easily localized. A household that's already giving \$1,200 a year (the national average) to charity can and should give it locally. If you want bad food, you can just as easily choose a local greasy spoon as McDonalds (ditto at the better food end). Choosing to spend discretionary entertainment dollars on local entertainment (plays, fitness centers, music events, dance clubs, music bars) instead of the nonlocal Cineplexes costs nothing more but does a lot for the community.
- Many of our expenditures – for education, health care, and most services – are already localized because local providers are clearly the most competitive.

These examples just begin to scratch the surface of the interesting opportunities that face consumers interested in localizing, and why it's ludicrous to generalize that nonlocal goods and services are cheaper.

Despite all the hype about globalization, large businesses overall in the past decade have expanded their position only slightly over local business (about 4 percent). Does this mean that global scale business is more competitive? Hardly. In my view, there are two other “market imperfections” that have dragged local business down during this period.

One is the pernicious role of economic developers. Nonlocal businesses are showered with at least \$50 billion of subsidies per year at the state and local level, and at least \$63 billion per year at the federal level. And the market tilt against local business doesn't stop there. U.S. securities laws give nonlocal businesses far better access to capital markets, leading investors to over-invest in large businesses and under-invest in small ones. The most significant pieces of banking, trade, insurance, and tax laws favor nonlocal business. For example, nonlocal businesses can write off the costs of leaving a community for a jurisdiction abroad, and then get a tax credit for taxes it pays to the government overseeing the maquiladora abroad.

The other market imperfection is the virtual collapse of anti-trust enforcement in this country. Increased mergers and consolidations is one of the trends economic developers use to suggest that bigger is more efficient. However, a recent review of the literature on mergers by Paul A. Pautler of the Federal Trade Commission (FTC) found that these deals actually depress stock value 45 to 70 percent of the time.²⁵ Perhaps the best explanation for merger-mania is an odd coincidence of personal interests between the acquiring and acquired firms. The acquiring company is willing to pay shareholders of the acquired company a nice, short-term premium to gain control of the company. Meanwhile, the CEO of the acquiring company usually gets a handsome raise and bonus. The Federal Reserve of Minneapolis observes about banking consolidation: “The data suggest that, regardless of bank profitability, the bigger the bank, the bigger the compensation package its top managers

²⁵ Paul A. Pautler, “The Effects of Mergers and Post-Merger Integration: A Review of Business Consulting Literature,” monograph (21 January 2003), www.ftc.gov.

receive.”²⁶ Richard T. Bliss and Richard J. Rosen, both business professors, analyzed mergers between 1986 and 1995, and found that the typical deal boosted executive compensation by 20 to 30 percent. Moreover, for every million dollars of increased company size, those executives who expanded company size through real growth received, on average, only 54 percent of the wage increase that an executive deploying a merger did.

Local First demands that these policies that disadvantage local business, which most economic developers are silent about, be changed. But even if these policies remain in place, there are a bunch of other trends over the coming years that actually should improve the relative competitiveness of many local businesses in the years ahead. Among them:

- A growing number of businesses are finding that profitability comes from specializing in a particular place. Delivering just the right products matched to local demands, at just the right time, with minimal inventories, gives locals a competitive advantage.²⁷
- The growing diseconomies of large-scale distribution (in food, for example, it constitutes nearly three-quarters of what consumers spend) will lead to local innovation that takes advantage of the low-cost of local distribution.²⁸
- The rising cost of oil, accelerated by greater appreciation of its environmental costs, will make local production for local consumption more competitive, and Chinese production for global consumption via Wal-Mart less competitive.²⁹
- The shift from goods to services in all OECD countries will naturally inure to local businesses, which dominate most of the service sectors now and will continue to do so for the foreseeable future.³⁰
- Rising concerns about homeland security will naturally lead more communities to become more self-reliant, especially in basics like food, energy, water, and materials.³¹

²⁶ John H. Boyd and Stanley L. Graham, “Investigating the Banking Consolidation Trend,” *Quarterly Review* (Federal Reserve Bank of Minneapolis) (Spring 1991): 12.

²⁷ Bruce Greenwald and Judd Kahn, “All Strategy Is Local,” *Harvard Business Review*, September 2005.

²⁸ Stewart Smith, Professor of Public Policy at the Muskie School, personal communication, 2 December 2005. His recent data update his earlier work, “Sustainable Agriculture and Public Policy,” *Maine Policy Review* 2, no.1 (April 1993): 68–78.

²⁹ James Howard Kunstler, *The Long Emergency: Surviving the Converging Catastrophes of the Twenty-First Century* (New York: Atlantic Monthly Press, 2005).

³⁰ Paul Krugman, *Pop Internationalism* (Cambridge, MA: MIT Press, 1997), 213.

³¹ David Wessell, “Capital: Decentralization and Downtowns,” *Wall Street Journal*, 25 October 2001.

- The ballooning U.S. trade deficit inevitability will deflate the dollar (hopefully not catastrophically), which will make foreign goods more expensive and local goods more competitive.³²

These trends will benefit local entrepreneurs even if they do nothing different. But a growing number of local businesses are learning how to be more competitive. They are supporting one another with technical assistance and mutual credit. They are entering producer cooperatives that enable them to compete against the chains (True Value and Ace Hardware stores are all locals who have done very well this way against Home Depot). They are learning from the successes in northern Italy and forming flexible manufacturing networks in industries like food processing (Appalachia) and textiles (North Carolina). They are setting up local credit, local debit, local gift, and local loyalty cards that nudge consumers to buy local. All of these activities, often done in the name of Local First, are rooted in a free-market philosophy.

It would be foolish to claim – again – that the result of these trends is that *all* local businesses will offer better goods and services than non-locals. I’m not making this claim and neither are most advocates of Local First. But this is the kind of generalization that Hodges insists upon plugging into economic models because it’s the only way he can possibly get the results he wants.

The Comparative Advantage of Local First

What’s left of Hodges’s economic arguments? Well, not much. He once wrote: “I was asked why there were no studies showing that these [buy-local] campaigns should not be viewed as part of an overall economic development plan. Where do I start? Those studies are the section in every introductory microeconomics textbook on comparative advantage. Those studies are the fact that mercantilism and isolationism have failed repeatedly throughout history.”

Hodges misunderstands Local First, and he may not even understand comparative advantage. Comparative advantage, as articulated by David Ricardo, touts the virtues of consumers freely buying and businesses freely selling. Local First does nothing to stand in the way of either consumers or businesses, or to embrace trade barriers. To the contrary, Local First is about giving consumers the best possible information for making choices. Consumer sovereignty – the building block of all microeconomics – lies at its core.

Local First encourages people to ask hard questions about their purchases and investments, to think through the meanings of bargains, to really do their shopping carefully. If I want to avoid wasting my hard-earned money on Wal-Mart’s “cheap goods” because they have high transaction or overcharge costs, because they are of poor quality, because they perpetuate worker oppression in China, because they turn my Main Street into ghost towns,

³² Paul Craig Roberts, “Collapsing Case for Free Trade,” *The American Conservative*, 6 December 2004, 16.

no misguided economist is going to tell me I have to do otherwise. I should be free to spend my resources any way I please. That's not protectionism. That's smart consumer choice.

Local First arms consumers with information and encourages them to buy local wherever they find the comparative advantage of doing so. Where they don't, they should feel free to buy global. But every dollar wasted on a nonlocal good or service that could be obtained locally at the same (or better) price leads a community to lose economic vitality.

The healthiest economy is both as self-reliant as possible *and* a strong exporter. Meet as many of your own needs as possible, *then* compete globally with a diversity of products. By being relatively self-reliant, you're far less vulnerable to events outside your control. By having global sales, you're not closing off your economy to outside goods and technology. Meanwhile, you're conducting as much business as possible with both local and foreign consumers, which brings wealth into the community and pumps up the multiplier. Cut back on *either* local self-reliance or exports, and you lose income, wealth, and jobs.

This may seem contradictory. If every community in the world became more self-reliant, wouldn't the aggregate level of imports shrink and make it difficult, if not impossible, for communities to increase their exports? In the short term, yes. But over the long term, import substitution would enable tens of thousands of communities worldwide to stop wasting precious earnings from exports on imports they could just as easily produce for themselves, and encourage them instead to reinvest those earnings on industries that could fill truly unique niches in the global economy. This would substantially expand the number and success of local businesses everywhere. It's a mistake to view any economy, especially the world's, as a zero-sum game where one player's gain is another's loss.

Opposing Local First winds up choking off the self-reliance part of the prosperity equation. It would limit local purchasing, limit the success of local businesses, and limit the manifold benefits that flow to Bellingham as a consequence. And this – in a nutshell – is why Hodges's views are so counterproductive and, if followed, dangerous.

If it's important to develop strong exports and to be self-reliant through import substitution, should both strategies be implemented simultaneously or should one be prioritized over the other? The prevailing view among state and local economic development experts is to prioritize exports. That's why the profession spends \$50 billion per year to lure and keep big, nonlocal businesses that are export-oriented. Only through export earnings can a community enjoy the potentially unlimited fruits of *new* dollars.

This argument is fundamentally flawed. How does a dollar brought into the community from export sales differ from a dollar retained in the community's economy through local sales? From a multiplier standpoint, there's no difference whatsoever. One academic analysis of eight southeastern states, looking at the relationship between local services and nonlocal non-service industries like manufacturing and mining, found both dimensions of the economy equally important. After reviewing this data, economist Thomas Michael Power observes: "Growth in service activities played a very important role in determining overall local economic growth. Manufacturing and other export-oriented

activities were not the primary economic forces. Others have also found evidence that ‘local’ economic activities may drive the overall economy rather than just adjust passively to export activities.”³³

Even though development through import replacement and development through exports propel one another, there are many compelling reasons to favor the former from a public policy standpoint. Import substitution involves shifting purchases from businesses outside the community to those inside, which usually means from businesses owned by outsiders to those owned locally. All ten benefits of local ownership are reinforced through import substitution. Every time a community chooses to produce its own apples rather than import them, assuming that the prices of all apples are roughly equal, it boosts the economic well-being of its own apple farmers, as well as all the local suppliers to the farmers and all the other local businesses where the farmers spend their money.

Paradoxically, import substitution also turns out to be the best way to create a healthy export sector. An unhealthy approach to exports is to do what Millinocket, Maine, did, which, as noted earlier, put all its economic eggs in the basket of paper production. Similarly, when economic developers attempt to divine what your community’s one or two greater “niches” might be in the global economy, they are essentially playing a dangerous game of Russian roulette. If your niche suddenly becomes obsolete, you’re dead. A far smarter approach is to invest in dozens of local small businesses, all grounded in local markets, knowing that some will then develop a variety of healthy export markets. A multiplicity of export linkages, anchored to the community through local ownership, is the most powerful and safest way to compete globally.

Even if import replacement leads to more exports, the distinction between this process and export-led development is much more than simply a matter of semantics. Development led by import replacement rather than export promotion diversifies, stabilizes, and strengthens the local economy, while allowing the best exporters to rise on their own merits. As Thomas Michael Power writes, “Export-oriented economies remain primitive, suffer through booms and busts, and go nowhere. It is only when an area begins making for itself what it once imported that a viable economic base begins to grow.”³⁴

Power, by the way, is just one of dozens of economists I’ve worked with around the country who embrace import-replacement and local ownership. These views can be found in the writings of Henry George in the 19th Century, and of E.F. Schumacher and the late Jane Jacobs in the 20th. Modern economists with these views include Robert Costanza (University of Vermont), Ann Davis (Marist College), Herman Daly (University of Maryland), Carlena Ficano (Hartwick College), John Ikerd (University of Missouri), Stewart

³³ Thomas Michael Power, *Environmental Protection and Economic Well-Being* (Armonk, NY: M. Sharpe, 1996), 125. (References omitted.)

³⁴ Power, *Environmental Protection and Economic Well-Being*, 133.

Smith (University of Maine), and Wim Wievel (University Illinois at Chicago). There are probably hundreds of such economists worldwide.

How Hodges Can Help

Let me conclude by appealing to the side of Hodges that sincerely wishes to preserve the sense of place Bellingham residents have so much pride in. Hart, in case your colleagues, friends, and neighbors aren't leveling with you, you're not helping anybody by "ranting" (your word) about Local First. If you're truly committed to helping the people and small businesses in Bellingham – and I believe you are – consider channeling your energy into more constructive activities. For example:

- Rather than poke holes in others' economic development ideas, why don't you actually write a book, a study, or even an article that really fleshes out your own. Try to map out a serious vision for Bellingham's future, and try to include as many residents as possible in your framing of that vision. And rather than just demand that others have their ideas peer reviewed, make sure yours are peer reviewed before you start circulating them.
- Rather than complain about the low wages of some small businesses, why not prepare studies that help pave the way for a living wage ordinance, so that we can raise labor standards for all business, large and small? If you dislike living wages (and minimum wages too?), why not propose other strategies raising the labor productivity of small business which in turn can raise their wages.
- Rather than encouraging people not to buy local because prices are supposedly too high, why don't you systematically work with small businesses (as I do) to give them access to technology and collaborative methods that enable them to perform more competitively?
- And why don't you team up with Local First proponents, in Bellingham and elsewhere, in systematically rooting out the biases in subsidies, public policy, and economic development planning that currently disadvantage local small business?

You have a good mind and good intentions. The people of Bellingham need them applied for the community's well-being, not Wal-Mart's.

Sincerely,

Michael H. Shuman
Vice President for Enterprise Development, Training & Development Corporation

Appendix I

A Response to Hodges Hodges by Dan Houston of Civic Economics

Matt Cunningham and I have taken the time to review and consider the comments of Dr. Hart Hodges regarding our 2002 study of BookPeople, Waterloo, and Borders. The tone of dismissive hostility was somewhat surprising, but we'll focus here on the numbers. Some thoughts:

1. The Austin study looked at two of the most successful independent retailers in America. Waterloo is routinely recognized by its peers as an outstanding retailer, and Publisher's Weekly named BookPeople Bookseller of the Year for 2005. Knowing that we had evaluated exceptional cases, we worked hard to find an opportunity to study a broader range of businesses and did so in Chicago in 2004 (www.AndersonvilleStudy.com). The "Local Premium" in that study was markedly narrower.
2. In both cases, we had the opportunity to sit down with cooperating business owners, open the books, and follow each dollar of revenue that enters the firm. For the independent businesses we have studied, we have absolute faith in those numbers. As to the chain businesses, which did not cooperate in these studies, we used corporate averages for all numbers, in all cases liberally crediting chains with local spending. Hodges can speculate on cost of goods, labor, etc. until the cows come home; we actually did the legwork to get those values.
3. Multipliers were applied to identifiable local spending for both chains and locals. They were quite low and accounted for very little of the outcome, just as one would expect.
4. Neither study included a formal comparison-shopping exercise. However, in the case of the Austin merchants, we would expect that BookPeople and Borders prices are almost identical, while Waterloo likely is cheaper. Therefore, any "benefit to consumers" is quite easily left aside. Moreover, we presented impacts per \$100 in consumer spending, to allow for price variation.

If Hodges wishes to contribute to the understanding of retail economics, he might start by approaching the issue with an open mind.

He would do well to visit a local merchant and talk to the workers who earn their living in the back office, providing services locally that chain competitors deliver from central locations.

We would love to see Hodges or any other academic economist replicate our work and go through the peer review process. In the meantime, his out-of-hand rejection of the very notion reflects more an ideological than an economic analysis.

Appendix II

The following memo from Dr. Hart Hodges was prepared, without my permission, to be distributed to a class I was co-teaching at the Bainbridge Graduate Institute.

To: Students at BGI
From: Hart Hodges, Director
Date: March 17, 2006
RE: Topics Course on Local Living Economies

I understand that you are exploring in one of your courses this year the concept of “local living economies.” I imagine that in the course you will be exploring the ways in which community based economies can promote sustainable business practices, improve land use and perhaps environmental quality, and offer other benefits.

During the course I hope you ask yourselves why the concept of local living economies is so appealing to many people. I believe that globalization, scandals associated with large corporations like Enron, and the sterile land use practices we associated with big-box retailers leave people feeling lost... if not threatened. But I wonder. When I read claims on web sites like <http://www.livingeconomies.org> and in books like Going Local, by Michael Shuman, I wonder if the recommended actions and policy positions could possibly generate the desired results. I too am concerned about the distribution of costs and benefits associated with globalization. And I worry a great deal about the linkages between economic activity and the environment (that is why I went to graduate school in economics in the first place). But I worry that the idea of local living economies might not be a meaningful way to address the underlying problems.

Economists like me are trained to focus on the positive (as in, the descriptive) rather than the normative (ought or should) dimensions of a topic. So when I hear people express concern about big box stores or globalization, I wonder about questions I can address in a descriptive or empirical framework. For example, I wonder if smaller firms are having more trouble today than they did in the past. If we continue with business as usual will the landscape become dominated by homogenous chain stores? Some say yes and some say no. I have my biases, but try to look first at the data for clues.

Bloomington's and Wannemaker's opened in 1872. So “big box” department stores have been looking for ways to take advantage of their economies of scale and have been trying to leverage their wholesale buying power for 140 years. Wal-Mart may have pushed supply chain management more than other retailers, but did not introduce something new into the dynamics of the market place. No matter what you think about Wal-Mart and other big box stores, a quick glance at data on the number of firms and the average size of firms, as well as “nonemployer statistics” (an indicator of sole proprietorships) reveals that entrepreneurship is alive and well. It is really rather difficult to point a finger at stores like Wal-Mart and conclude that local economies have suffered. But maybe the regular indicators don't capture what is important.

If the number of firms in a town do not go down when Wal-Mart opens... or in the subsequent x years, then what should we study to determine whether Wal-Mart has hurt the local economy? We might look at wages... or the cost of living. What if you find that the average wage in the retail sector in communities with chain stores is higher than in communities without chain stores? And what if you find that the chain stores reduce the cost of living? Interestingly, those results are very common in counties across the US. (See for example, <http://www.globalinsight.com/Highlight/HighlightDetail2436.htm>.)

My personal preference would be to live in a town with relatively few chain stores. I like shopping at Kid's Northwest in Bellingham (a clothing store for children). They know my name and they know the clothes that my daughters like. I feel very comfortable when I shop there. In comparison, I find that shopping at Target and other big box store is very sterile and often depressing. I'm willing to pay a price premium to shop at Kid's Northwest and am eager to participate in efforts that help businesses like Kid's Northwest remain viable.

As such, It would seem that I should endorse efforts to promote local living economies. I accept the idea of a price premium for consumers... and I agree with certain value statements or positions endorsed by the Business Alliance for Local Living Economies. However, I see problems. I worry about people who cannot afford to pay a price premium. I worry about the validity of underlying claims. And I worry about the inconsistencies in the various arguments.

Maybe I'm getting the cart before the horse. Perhaps the push for local living economies is not intended to be viewed as a form of public policy. But it is viewed that way. So I have to ask whether the ideas provide a good foundation for policy. You should be discussing such things amongst yourselves. In your course, you should be asking yourselves what is the real value of the concept.

I heard of a discussion once about possibly having Crate and Barrel in downtown Bellingham. One elected official was reported to say that having a chain store like that in downtown Bellingham would not be good: "it would be too much competition for (the existing, local home furnishings store)." Being curious, I have asked several members of the city council if there is any truth to the story. I've been reassured it captures the correct sentiment... which makes me worry that the push for local living economies is, in fact, getting traction with policy makers. Does that worry you – or reassure you? That is, do you think policy makers are thinking about the nature of business and economics in general in a manner that will improve the welfare of the people of Bellingham? Or might the reverse be true?

The person who owns the furniture store across the street from where Crate and Barrel was rumored to be moving said she would love to have them across the street. She knew there would be competition, but that there would also be more people in front of her store. And there would be more choices in town. She thinks policies should be designed to keep stores like Kid's Northwest healthy while also encouraging stores like Crate and Barrel to come to town. She doesn't think it is about one versus the other. She thinks it is about both, together.

Still, there is a lot of talk about how certain types of businesses are bad and other types are good.

Can we say that Wal-Mart and other big-box retailers are bad in some sense? Would our communities be better without Wal-Mart? I've read many editorials that say Wal-Mart is based on a business model that is simply inconsistent with the idea of a healthy community. Why? Can't sole proprietorships be just as unethical as a major corporation? Exactly what is it about Wal-Mart that is so bad?

Is it the corporate model that is problematic? Do we run into problems when business owners (e.g., shareholders) are separate from managers? There is a vast literature on principal-agent problems. I assume you will be covering a portion of that literature in your course.

Part of the reason I'm writing this memo is to remind you that whether or not business type A is better than business type B is to a large extent an empirical question. Another reason is that I want you to get beyond the initial rhetoric. I want you to be able to state very clearly what about Wal-Mart and other big box stores is so worrisome. If there is a problem and we are to address the problem in a reasonable manner, then we need to be able to articulate what is wrong and what we want to do about it. We also need for our positions to be truly defensible (e.g., with data and structured theory, not comments like, "it only stands to reason" or "it's intuitive that...".)

You can find on the Business Alliance for Local Living Economies web page a discussion about how Wal-Mart charges different prices for pharmaceutical products in different towns in Maine. The claim offers, "What was apparent was that Wal-Mart's prices are lowest in areas where it is fairly new on the scene, and highest in towns where it has largely eliminated the competition." Was it really so apparent? Did the authors really determine what they are claiming? Wal-Mart has a corporate policy of charging the lowest prices in a town. They send out price checkers to competing stores. Perhaps the stores referenced in the claim where there were higher prices were in markets where all prices were high. Maybe the stores had to be smaller or had to pay higher transportation costs. Did the people making the claim control for all such factors? The answer to all those questions may be yes. Still, you should be skeptical.

Mike Hoagland runs a pharmacy in Bellingham. When Wal-Mart announced it was going to open a store in Bellingham there were many editorials saying all the small, local pharmacies would be forced to close. They didn't. In fact, you can make a table that shows the number of firms in various retail sectors in this region and highlight the date at which various Wal-Mart stores opened. In Whatcom, Skagit, and Island Counties there is no decline in the number of firms associated with the opening of any Wal-Mart. Moreover, Hoagland's Pharmacy actually grew after Wal-Mart arrived and Mike Hoagland has said Wal-Mart was one of the best things that ever happened to his business. He knew he couldn't be the low cost pharmacy (that's Wal-Mart) or the 24-hour pharmacy (that's Walgreens), so he had to focus on what he did really well. Today, Hoagland's is the only pharmacy that compounds medications for area doctors and provides delivery services for area nursing homes. They know their customers and they carry unique products for those customers. They also know

full well that their customers shop at a range of pharmacies (and other stores). It is not about Wal-Mart versus Hoagland's. It's about Wal-Mart AND Hoagland's AND other shops... of various types and sizes. (Note: the Fairhaven Pharmacy and Fountain Drugs also continue to do well in Bellingham, despite the presence of Wal-Mart.)

Of course, one story or example is not enough. You should never base policies or theories on anecdotal evidence. You can prove anything if the requirement is to find one example that supports your idea.

Stores like Kid's Northwest and Hoagland's Pharmacy represent something positive about the community based business model. They suggest there is something valid about a Think Local First campaign or buying local in general. But they are anecdotes. There are also offsetting examples such as a computer store in downtown Bellingham. This store orders supplies from online retailers and marks up the prices. I can use the same online retailers and keep the money in my pocket (so it stays in the community). The store is not selling unique or special products and does not offer good customer service. I know one current and one past employee from this store. I know of problems with employee turnover and I know they pay their employees exactly what Wal-Mart pays its employees. This store does not create an economic premium when someone shops there. Nor do they do anything particularly well. Still, they are viewed as special because of a successful marketing campaign that calls attention to locally owned stores.

Is that what we want? Do we want businesses that do not offer exemplary customer service, unique products, or above average compensation packages to be rewarded because the owner lives in a particular place or the business is a particular type? To the extent that we want only certain types of businesses in town to succeed, the answer is yes. But to the extent that we want to improve the local economy, the answer is no. Why view a store as special when it is not?

Maybe I'm once again getting the cart before the horse... or worrying about the wrong things. Even if the business is not unique in any way or particularly efficient, it might still be preferred to some generic chain store. Moreover, we need to consider the human dimensions of economic transactions and pay attention to the idea of responsibility. Many people believe that owners of small, local businesses are more connected to their communities and more likely to be guided by a sense of responsibility.

You should be discussing such things in your class. You should be debating with each other when a particular business should be rewarded... and why. What do we mean when we say we want a business to consider its social and environmental responsibilities? Where should we draw the line with regards to such matters? Should we celebrate only those businesses that are, say, pro union... or perhaps that have a strong pro-life agenda? And what about the environment; what evidence and what level of proof do you think would be needed to know if a business's positions were valid?

What happens when these items are in conflict? You might imagine for a moment a business endorsing a policy of no logging in the Lake Whatcom watershed. No logging would reduce

runoff into Bellingham's supply of drinking water and have other benefits as well. But no logging would also reduce timber revenues that go to one of the local school districts. What sounds nice on the surface can actually be problematic, especially in terms of public policy.

It's very easy to say small, local businesses are more connected to their communities and that the behavior of the owners will reflect their connections. You need to discuss amongst yourselves what that really means and what role businesses should play in furthering certain social or environmental policies. There's a rich literature on business ethics that addresses this topic. You might want to consult that literature while having your discussions.

Maybe the old tag line from the Twilight Zone is also worth repeating: "Things are not always as they seem." You need to be critical. You need to challenge your own and each others' ideas about business and community. You need to be skeptical about what sounds nice or feels good.

I ask my students in introductory microeconomics to give me an example of predatory pricing. We discuss what the concept means, what businesses might engage in the practice, and why. Every single time I ask for an example someone says something like the following: predatory pricing is when Wal-Mart goes into a town, set's prices very low to drive out the competition so they end up with a monopoly... they can do whatever they want when the competition is gone. An extreme version of the story has Wal-Mart operating at a loss for a short time with prices so low that no one else can compete. They say Wal-Mart is big enough to operate that way....

If a company operates at a loss for some period of time, it has to offset that loss with sufficient profits in the future. When the company raises its prices to generate those profits, other firms will enter the market. If you think about it, the Wal-Mart predatory pricing story outlined above works only if Wal-Mart can block entry. But they can't. Moreover, if the story was a good description of how things really worked, there would be a paper trail. We'd see in the data a decrease in the number of firms in areas where Wal-Mart opened its stores and an increase in prices at some point thereafter. We see neither.

I'm well aware of studies that show the negative impact of Wal-Mart. I know that you can quote economists who say as much. For example, I've read several pieces by Kenneth Stone at Iowa State University. Some say he has documented the negative impacts of Wal-Mart on communities in Iowa. But much of his work is taken out of context and/or misinterpreted. He prepared a paper titled "Impact of the Wal-Mart Phenomenon on Rural Communities" in which he shows trends in retail sales in towns with and without Wal-Marts. He notes that whether your community benefits if Wal-Mart locates a store in your town, but the gains come at the expense of others and are fleeting. Read the study – and ask yourself a few questions about the study period. Ask yourself if there is a downward trend in retail sales in all towns in Iowa, regardless of whether a Wal-Mart is present, what else needs to be considered. What about the broader downward trends in population and economic activity in all rural towns in Iowa during the study period? What happens when you control for the broader demographic and economic factors? (There's a reason his work was published by the Farm Foundation and is not found in a peer reviewed journal.)

Please note – I am not suggesting that everything is fine with Wal-Mart and/or other chain stores. I have concerns. I just don't think the popular rhetoric makes sense. And we should be very, very careful about our rhetoric when thinking about public policy options. **In the absence of good analysis, we may design policies with unintended consequences.**

Other bits of rhetoric that need to be addressed include things like the following:

- Small business or local businesses create most jobs
- Buying local results in an economic premium
- Local living economies result in less environmental impact

The real challenge is to understand the sentiment behind each of the bulleted items above and to balance that sentiment with something defensible.

What type of businesses do you think create the most jobs in a community?

As graduate students you should try to get beyond arguments of opinion. Think about how you would address that question if it were an assignment. You could survey the literature to see how others have thought about the question. You could examine data from the Bureau of Labor Statistics and Bureau of Economic Analysis. And you could conduct interviews with business owners and staff at job placement agencies. After doing these things you would have more than just an opinion. Here's a challenge: do a quick search on the BLS or WorkforceExplorer web pages for any community to see what data are available. Can you find any business level data to even begin to make the claim that one type of business creates more jobs than another? Can you find ownership information at the same time?

In the 1930s Joseph Schumpeter, a famous economist and economic historian, believed that small firms were the engines of growth. To understand job growth, he studied business "births" and "deaths", access to venture capital, and many other factors. The ideas he and many others of the time developed became known as the Schumpeter Mark 1 regime. Interestingly enough, by 1950 he believed that large firms were critical for economic growth. This alternative view, later known as the Schumpeter Mark 2 regime, included the idea that large firms were needed because large firms could invest in R&D and take advantage of efficiencies of scale to pay better wages.

David Birch, a physicist at MIT, waded into the job growth debate when he published a paper in the late 1970s saying that small businesses were the source of most new jobs. Despite the fact that his work was found to be flawed, with programming errors and other mistakes, the positive view of small businesses continued to grow.

More recent studies have suggested that small firms were critically important for economic success in certain decades – such as the era of "right sizing" in the 1980s and early 1990s. Some of these recent studies remind the reader that the official definition of a small business is any business with fewer than 500 employees. However, some studies are not as careful. Always remember, claims about economic growth require careful consideration of what is growth (is it jobs, wages or something else), the type of firm (results can vary by sector), the time period (what is true in one period may not be true in another), demographics, fixed

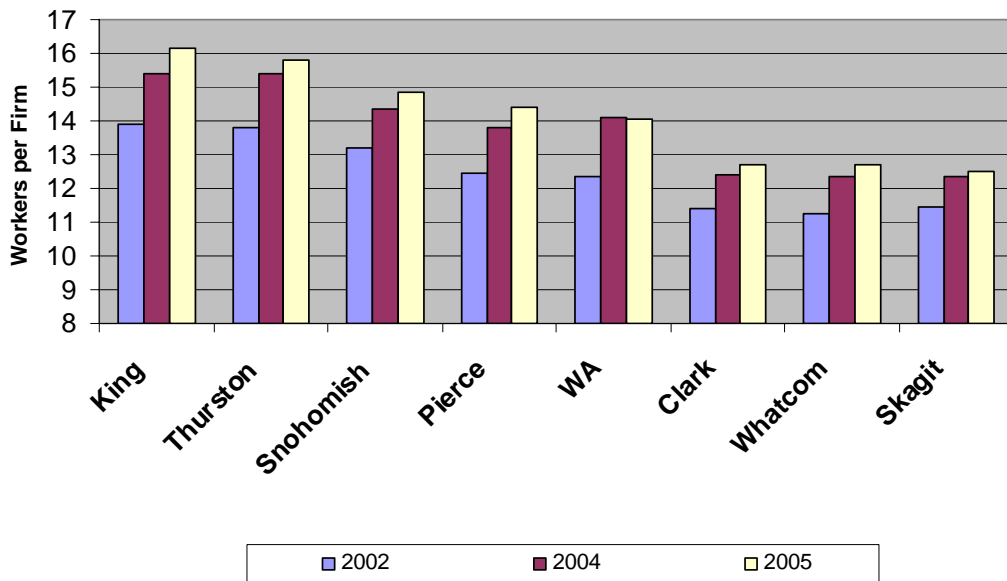
effects (from infrastructure to climate), and geography or spatial issues. Handling these issues in a statistically valid manner is no easy task.

In my research I've found job growth to be very spatially dependent and wage growth to be positively correlated with firm size. My results come from econometric analyses of firm size, firm concentration, wage growth and other factors for all 3,100 counties in the US from 1980 to 2000. I've found the same results using data for 900 cities in the US – summarized in a paper I'm submitting for publication in Economics Letters this spring.

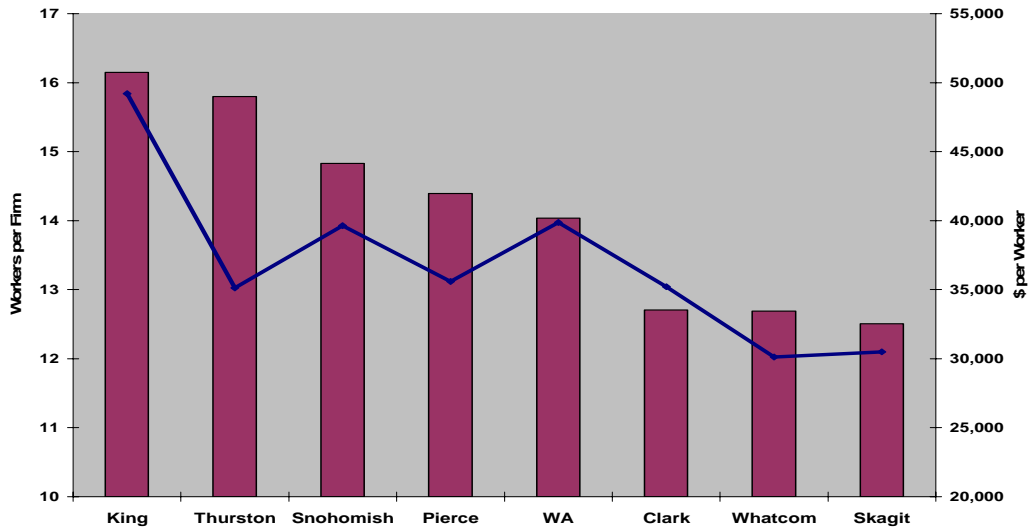
One thing I notice in my work is that the positive correlation between firm size and wages is not impressive. That is, bigger is better when you control for other important factors and are careful with the statistics... but the effect is quite small. I do not find that bigger is a lot better. And one of the factors in my control group is firm concentration. Along with bigger is better, I find that a good concentration of firms is important. I don't like the word "clusters", but what the heck. It gives the right idea. Having lots of small businesses that work together is helpful. (Once again an academic goes to great length to prove the obvious.)

It's not a simple topic really. And I worry that people who try to make it simple by offering comforting claims and platitudes do more harm than good.

Consider the following data from the Washington State Dept. of Employment Security.



The data invite a few questions: Why did the average firm size increase in counties in Western Washington following the recession of 2001? Do entrepreneurs accept attractive offers from larger firms during expansions? How does firm size affect performance – are wages or other indicators better in communities with smaller firms? You could check...



The bars show firm size and the line shows average wage per worker...

Why are wages correlated with firm size? Schumpeter and others believe larger firms enjoy more economies of scale and have the ability to pay higher wages. If so, would policies that protect small businesses be counter to policies that encourage “living wage jobs”? I don’t think it is so simple.

My apologies – this memo is much too long. Let me close with two challenges:

Imagine that you are on an advisory committee. The mayor of a smaller city has asked your committee how it should invest its economic development money. It spends \$250,000 to \$500,000 per year on projects and studies related to economic development. How do you think the money should be spent?

What policies do you think would help business be able to pay higher wages? Be careful to think about environmental and community goals.

Separately, focusing for a moment on environmental quality and accepting the notion that political change often begins at the local level: Do you think we can get more improvements in environmental quality/policies by pushing for local living economies or pushing for changes in the current economic model... and why?

I’d like to hear your thoughts.

Appendix III

The following op-ed from Hart Hodges, "Buying Local: Does the Myth Need De-bunking?," appeared in the Bellingham Business Journal, 1 January 2005.

Many stores around town have "Buy Local" posters in their windows. The posters offer reasons to support local businesses. Some of the posters--like the one that says buying local encourages competition--don't make sense. Rather than believe what the posters say, I interviewed several local business owners and managers at chain stores. I learned that there are cases where spending money at a local store means my money stays in the local economy a bit longer than if I had supported a chain store.

However, I also learned that the reverse can be true and that the facts and figures on various posters around town are misleading. I also reviewed several of the studies used to support various buy local campaigns, including the one in Bellingham. I found that the authors of those reports made heroic assumptions and often warned readers that the findings may not be appropriate for other businesses or cities.

The idea is that money given to a locally owned store stays in the local economy longer, thereby strengthening the local economy. The notion has a certain intuitive appeal, but is an oversimplification and a bit misleading.

A can of tennis balls at the Sportsman Chalet costs \$3.50. The price is \$3.25 at the Bellingham Tennis Club. Both are local businesses. The same balls cost \$1.99 at Big-5 and Wal-Mart. If I spend the extra money at the locally owned stores, I am not really helping the local economy. Part of the reason the balls cost more at the local stores is because they pay a higher wholesale price. As such, most of any extra expenditure goes away immediately. It does not stay in Whatcom County to be invested ever so wisely by the local business owner.

In general, the buy local campaign glosses over many difficult issues. Should I assume that employees at a locally owned store spend their money in a way that benefits the local economy while employees at Costco do not? What about employee compensation? There are many cases where national employers offer better pay and benefits than do small, local companies. And how do I define local? I can think of chain stores that sell products made in the U.S. and locally owned stores that sell products made somewhere else. Which is local? Does local include Lower Mainland B.C. or other parts of the Pacific Northwest? And what about people who survive on Wal-Mart prices?

Some posters say that buying local creates more local jobs. I suppose the idea is plausible, but I have questions. The evidence suggests that job growth tends to come from small businesses, not just those owned by particular individuals. And I wonder about the quality and long-term value of the jobs we create if we focus on businesses owned by people who live in a certain place. Why not embrace the challenges of true competition (i.e., global) so we can create jobs that will be longer lasting and allow for higher wages?

I believe that competition builds stronger communities and that businesses succeed in the long run only if they motivate people to be patrons--because of unique products (including items made by local artisans), personalized customer service, or the quality of items sold. In addition, I think we should support businesses where the owners are socially and environmentally responsible. I buy tennis balls at local stores for those and other reasons, not because the owners live in town.

Now--despite my ranting, I applaud Sustainable Connections and the other organizations behind the buy local campaign. The campaign helps people see that purchases are like votes. When individuals make purchasing decisions, they are in essence placing a vote on what they value.

If you want certain stores in your community and/or certain services, you have to pay for them. We just need to keep in mind that some people value locally owned businesses, while others value Wal-Mart and Amazon.

In the end, we need priorities to help us make decisions. To establish those priorities we need to understand what works and what doesn't when it comes to business and economics. It is my hope we can rethink the hype around buying local and move forward thoughtfully.