

THE VALUE OF A NORM: OPEN MEMBERSHIP AND THE HORIZON PROBLEM IN COOPERATIVES

by

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Abstract

The horizon problem has long been identified as being important to the functioning and behavior of cooperatives. This paper shows that the investment disincentive that a cooperative (both at start-up and ongoing) has vis-à-vis an IOF is less severe than has been typically argued. There are two main findings. The first is that the standard intuitive understanding of the effect of different horizons typically starts from the implicit assumption that cooperative members have the same objective as their IOF counterparts. When this assumption is relaxed it is shown that even when the horizon problem is at its most severe (e.g., during the creation of a cooperative by the original members), the cooperative may – under certain conditions – be more likely to make an investment than a profit-maximizing IOF. The second key finding is that once the cooperative is operating, the horizon problem is mitigated by the open membership policy of cooperatives. However, the open membership policy, which specifically does not assign property rights to specific groups, is not one that is chosen as an equilibrium strategy by the members. Instead, it is a policy that is adopted on the basis of principle. To sustain this policy, the cooperative needs to maintain features such as a strong identity that serve to make deviation from the open membership principle difficult.

Keywords: horizon problem, open membership, institutional norms