

# Community-Based Economic Development Projects Are Small but Valuable

*Many small towns are adopting community-based economic development strategies, such as community-owned firms and community-oriented finance institutions, to promote development. On the plus side, such projects have created jobs, promoted a sense of local ownership, and retained much of the created revenue within the community. On the down side, the number of jobs created or saved has been modest, access to capital can be difficult, and managerial experience is often limited.*

**E**CONOMIC development has become perhaps the dominant policy issue facing most local governments in rural areas in the 1990's. Many small towns have adopted tax incentives, provided financial subsidies, and constructed buildings in an effort to attract new jobs and generate income. This increased competition for jobs, particularly for manufacturing jobs, among communities has been labeled as the new "arms race." Likewise, the Southern Growth Policies Board referred to this competition as the great buffalo hunt, with more and more hunters chasing after a few buffaloes. As an alternative, many policy-makers, practitioners, and academicians have encouraged communities to promote growth through the use of local resources so as to retain local control of enterprises and activities. The goals of such strategies are to create new jobs in ways that limit population loss in rural communities and to make communities less dependent on external organizations. In addition, community-based development is aimed at enhancing the sense of community in rural areas.

In this article, we examine community-based economic development strategies (*self-development*) to assess how they are initiated, their relative costs and benefits, and the factors influencing their success. We use recently collected data from more than 100 rural communities

with self-development projects (see "About the Study"). Among our key findings:

- Most self-development projects are initiated due to a specific crisis in the community or region.
- The major obstacle reported by respondents is access to capital.
- Small communities are more successful at implementing self-development strategies than are large communities.
- Over 90 percent of the jobs created by self-development projects are filled by local residents.
- Local governments are probably more important in the implementation, rather than the initiation, phase of self-development projects.

## What Is Self-Development?

Self-development strategies involve local governments or quasi-governmental units working with other public and private entities to generate income or to create a net increase in jobs in a community or region through (1) involvement of local organizations (in most cases, including a local government), (2) investment of substantial local resources (this does not preclude use of outside resources), and (3) local control of the enterprise or activity that is created. This study is limited to self-development projects in nonmetro areas that have been implemented since January 1980. Self-development, as defined here, does **not** include the establishment of a business by local entrepreneurs. Nor does it include recruitment of Federal or State facilities, such as a prison or job-training facility, which are not locally controlled.

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### About the Study

Beginning in 1988, we used existing bibliographies and databases of economic development efforts to identify communities implementing self-development strategies. We also contacted several organizations involved in community and economic development, such as the National Association of Towns and Townships and members of the Community Development Society. More than 600 key informants from various agencies in all 50 States (State departments of economic development, Cooperative Extension rural development specialists, Economic Development Districts, and Regional Planning Commissions) were asked to identify innovative self-development cases in their region or State.

By September 1989, we had learned of 249 cases that appeared to meet our criteria (see **What is Self-Development?**). We sent a questionnaire to all of these projects and received 160 completed questionnaires. The final step was verification of the cases through telephone calls and additional mailings. We determined that 57 of the 160 did not fit our criteria for self-development, and that 41 cases that did not answer the original questionnaire also did not qualify. We ended up with 103 cases for our analysis (a response rate of 68 percent). In-depth studies of 8 of the 103 projects yielded valuable information on the process of self-development.

The survey data were merged with census data on the social and economic characteristics of the communities, which allowed us to analyze the relationships between community and project characteristics. One focus of our analysis was to explain the number of jobs and amount of income generated from self-development projects. Community size is a strong predictor of job creation, with small communities producing more self-development jobs. There is, however, no statistically significant relationship between community size and income generation. There were also some differences among the various types of self-development projects in terms of the number of jobs created or saved. Local industrial development projects tend to produce the greatest number of jobs and at the least cost.

Case studies were conducted in eight self-development communities. The purpose of these case studies was to obtain in-depth information from community leaders and participants on the processes involved in initiation, organization, and implementation of self-development projects.

We classified projects in terms of their primary activity (see "Examples of Self-Development Projects," pp. 14-15). Many projects, however, involve more than one type of activity. For example, Ganados del Valle, a Hispanic collective enterprise in New Mexico, includes a sheep-grazing cooperative, a weaving cooperative, an enterprise that sells organic lamb to area restaurants, and a general store. The collective qualifies as a community- and worker-owned enterprise, a tourism project, and a value-added firm.

Tourism and cultural activities are the most prevalent types of self-development projects, followed by retention and expansion of existing businesses and locally controlled industrial development (fig. 1). Community-based service firms, agricultural marketing organizations, and community financial institutions are much rarer. Tourism and locally controlled industrial development may require less community support and fewer resources than do community financial institutions or community-based service firms.

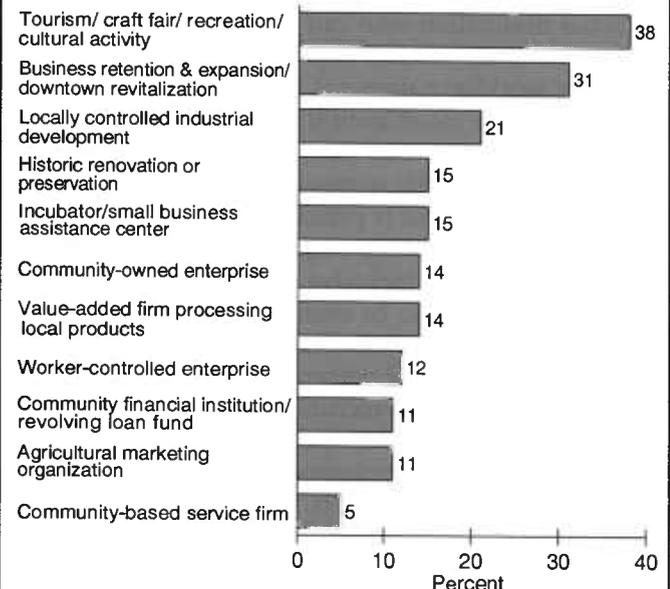
### Most Self-Development Projects in Midwest...

Most self-development projects (51 percent) are located in the Midwest. Seven percent of the projects are in the Northeast, 23 percent in the South, and 20 percent in the West. The regional distribution of community-level self-development projects corresponds closely to the regional distribution of incorporated places. Of the 80 projects for which place (geographic community) was relevant, only 5 were in unincorporated places. Thus, incorporation seems to be a threshold indicator of a locality's ability to act collectively.

Nearly half of the projects (47 percent) are limited to a local town or village. Twenty-one percent are county-wide, 25 percent are multicounty projects, and the remainder (8 percent) are either statewide or regional. Multi-county and statewide projects are constrained because there is often a conflict among localities over where the new jobs will be located. Thus, many of these projects are service providers to communities and businesses.

Figure 1  
**Type of self-development projects**

*Most numerous are tourism and business retention projects*



Note: Percentages add to more than 100 percent because some projects fit more than one category.

### ...in Smaller Communities

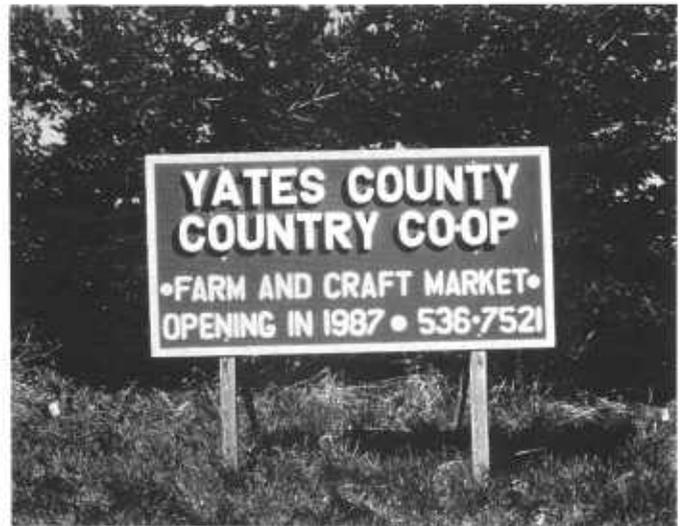
The literature on local economic development leads one to expect that larger communities will be more successful than smaller ones in creating jobs because of the greater availability of managerial expertise, skills, capital, and other resources. That's not what we found, however. True, we found that community size was a strong predictor of the number of jobs created in self-development projects. But the relationship was the opposite of the expected—smaller communities in our sample were likely to generate more jobs than the larger communities. The reason may be that grassroots efforts are easier to implement in small than in large communities because of the more frequent and closer personal interaction among individuals in small towns. This interaction is necessary to gain broad community support for a self-development project.

### ...With Dispersed Leadership

Self-development communities can be characterized as having a flexible, dispersed community leadership structure. Elements of such a leadership structure include at least the following: (1) there is a rotating community leadership structure (no single group or individual is in a leadership position forever), (2) newcomers are allowed to take leadership roles in the community, and (3) the climate is favorable to the participation of women and minorities in leadership roles in the community.

Our results call into question the efficacy of the "sparkplug" theory of leadership for this kind of economic development. For other kinds of development projects, such as industrial recruitment, the "sparkplug" may still be desirable. Firms looking to move a branch plant may prefer to deal with only one person at the potential destination who can get things done. In addition, secrecy is often required by such firms so that their workforce does not know that the firm is contemplating a move until it is a *fait accompli*. Industrial recruitment and self-development, therefore, may work best under polar opposite forms of organization. Industrial recruitment is perhaps best carried out by tightly linked hierarchical organizations with one person in charge, while inclusive or community-wide self-development seems to be more effective under a participatory mode where no one leader is indispensable. Nevertheless, nearly 30 percent of self-development communities have also recruited industries in the 1980's, suggesting that leadership styles appropriate to these two economic development approaches may have some common elements.

In virtually all of the self-development case studies, newcomers were essential to the initiation and implementation of the project. In most instances, these



This co-op in New York provides a location for farmers and craftspeople to sell their products. © Gary P. Green

people had migrated to the community in the relatively recent past. Newcomers frequently have a wider range of experiences and have more outside contacts than do natives. They see things from a different perspective than do long-term residents and are not yet enmeshed in the multiple community roles that often prevent long-term residents from pushing for change.

The Windmill Market of Penn Yan, NY, is a successful craft-marketing cooperative that serves the Finger Lakes Region. This project incorporated both newcomers and natives into the development process. Penn Yan had various groups of newcomers, including a settlement of Mennonite farmers from Pennsylvania, as well as artists and craftspeople who had settled in the region. The newcomers were considered an asset to the cooperative market. At the same time, a native of Penn Yan and loyal Rotarian, with the assistance of his wife, was the chief initiator of the self-development project.

### ...And in Communities Facing a Crisis

In more than half of the projects (54 percent), self-development activities were initiated in response to a crisis in the community or region. The two most frequently cited events leading to the creation of a self-development project were a downturn in the local economy (44 percent of those reporting that a crisis initiated the effort) and a plant closing (39 percent). Local stimuli (such as plant closings) and the more general rural economic stagnation in the 1980's help explain the initiation of self-development efforts. Under these crisis conditions, traditional approaches toward economic development are less likely to be considered viable, and communities are more likely to consider grassroots efforts at generating jobs and in-

come. A crisis may be a necessary, but not a sufficient, condition for self-development to occur.

### Self-Development Creates Skilled Jobs with Little Revenue Leakage

Self-development projects do not produce a large number of jobs, particularly when compared with successful industrial recruitment efforts. An average of 51 jobs were reported created or saved through self-development efforts. The median number of jobs produced or saved through self-development projects, however, was 25.

Self-development efforts generate a wide range of job opportunities that are not concentrated in unskilled or low-paying positions. Among the self-development projects, only about 36 percent of the jobs created or saved are unskilled or entry-level clerical, with the remainder being managerial, professional, and skilled manual jobs.

Over 90 percent of jobs created by self-development are filled by long-term local residents. The small scale of most self-development firms may generate too little publicity to attract workers from outside the community. Self-development projects are small in terms of capital and sales. Self-development activities averaged gross annual sales of slightly over \$1 million. The median gross annual sales generated was \$150,000. The difference between the mean and median values is due to the presence of a small number of large enterprises in the sample.

Because self-development is based on local ownership and control and predominantly employs local residents, much of the income generated through self-development projects likely remains in the community. Income generated through sales at a branch plant or a franchise in a small town frequently does not remain in the community and so has fewer benefits to local residents. Self-development projects' economic impact on the community is, therefore, likely to be proportionally greater per dollar invested because the surplus generated through the economic activity continues to work its way through the local economy rather than immediately shifting to other regions.

### Other Costs and Benefits of Self-Development Projects

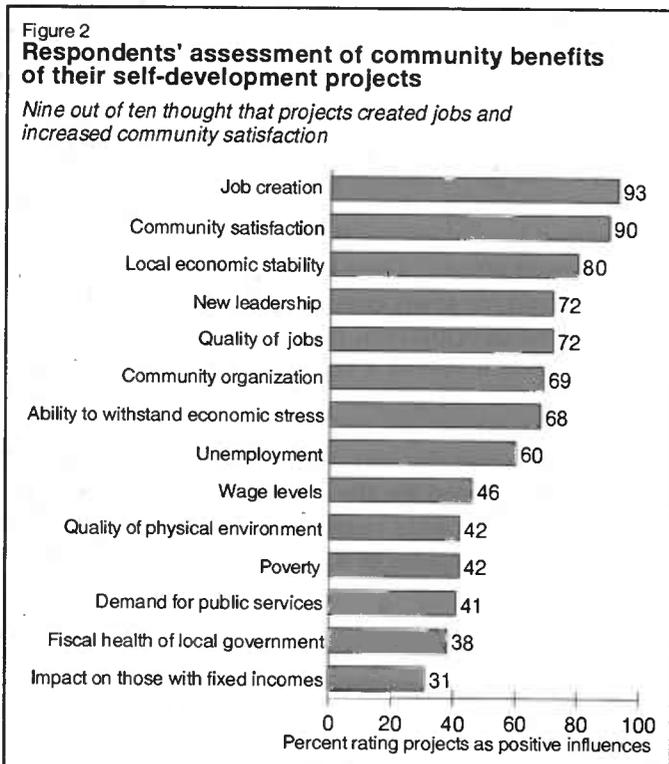
In most cases, the local government did not forgo significant revenue (tax abatements and credits) to support the self-development project. In only 16 percent of the projects did a local government forgo any revenue, and even then, it was not a large amount. Five of the 10 respondents estimating lost revenue indicated that the amount was \$1,000 or less. Those 10 local governments were willing to forgo revenue for 4 years, on average, to support the project.

Local government assistance was much more likely to be in kind rather than cash. More than a third of the self-development projects received in-kind benefits provided by local governments. Such benefits were primarily services, such as use of a machine or grant-writing assistance, a building, or some form of labor.

Self-development projects were perceived by respondents to have a broad set of impacts on the community (fig. 2). In addition, many respondents credited the self-development project with lowering unemployment and improving the quality of jobs in the community. Of the 14 aspects of community life considered, self-development is reported to have the strongest positive impact on job creation, community satisfaction, and local economic stability.

### Obstacles to Self-Development

The obstacles facing self-development projects are generally similar to those faced by most businesses. Acquiring information and financing may be more difficult for self-development projects because they are to some extent nontraditional. Respondents reported the availability and cost of debt capital as the greatest hindrances to or complications for the self-development project (fig. 3). Lenders generally believe that self-development projects are risky because in most cases the projects have no collateral. Participants in the self-development projects expressed a great deal of frustration with local lenders. Local lenders, they said,



had little experience lending to self-development projects and thus no basis to appraise risk. Several respondents blamed the lack of financing on the loss of local (as opposed to branch) banking; others complained that the lack of support from local lenders was symptomatic of the lending conservatism that has always existed. Most of these projects were initiated during 1985-89 when capital markets were relatively loose, so a period of tighter credit may exacerbate these problems.

Self-development projects used a wide variety of funding sources, categorized here into four types: local-public, nonlocal-public, local-private, and nonlocal-private. The largest amount of funding to all 103 projects surveyed came from nonlocal-public sources, and the least came from local-public funding. Nearly two-thirds of self-development activities were funded from outside the locality in which the project was carried out. Public sources of funding for self-development projects were distributed as follows: Federal programs (less than a third), State government (less than a fifth), and local government (more than a tenth). The Federal Government continues to be a major source of capital for community economic development activities despite significant cuts in Federal spending for rural and community development during the 1980's.

Although the mean amount of local and outside private funds received by all self-development projects were virtually equal, the local funds were much more

broadly distributed than were those from the outside. Half of local-private funds were provided by individuals and one-fifth by local businesses. Only 10 percent of the projects received local-private funds from banks, which corroborates our earlier assertion that banks are largely unwilling to loan to self-development projects.

Successful projects were able to gain access to some local sources of capital and leverage it to obtain larger amounts of funding from nonlocal sources. This strategy generates local interest and support for the project (as opposed to external funding which excludes the community from full participation). By demonstrating local support, project leaders find it easier to solicit outside funding to initiate the project.

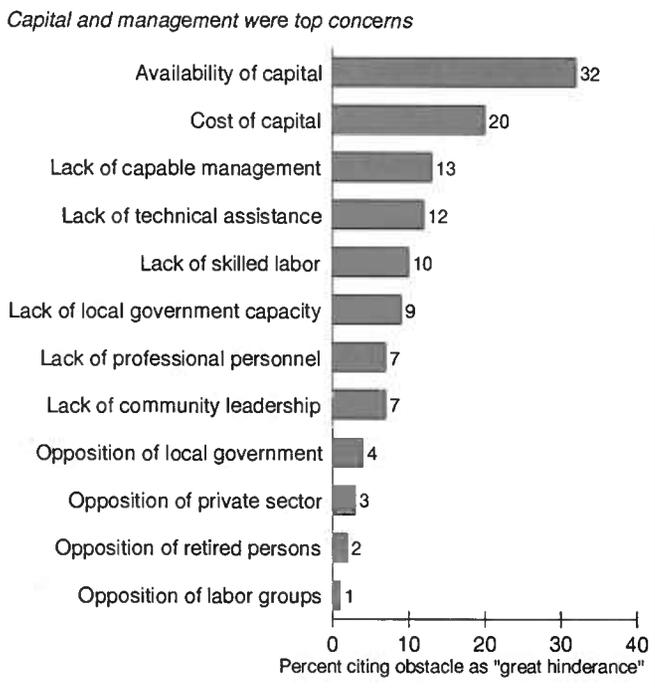
The second tier of obstacles includes those related to lack of human and organizational capacity within the community (lack of capable management, skilled labor, and local government capacity) and poor access to such capacity from outside the community (inadequate technical assistance). Still, each of these was perceived to be a problem for only 9-13 percent of all projects. The case studies of failed self-development efforts suggest that while lack of capital was frequently given as a reason for failure, a more objective assessment indicates problems with management, which respondents felt could be overcome with more capital. Although credit problems are real, they are often difficult to separate from managerial decisions. Thus, the modest concern with management problems reported here may be deceptive.

### Self-Development Projects Need Local Governments; Local Governments Need Outside Expertise

Several factors influence the success of self-development efforts in rural communities. Local governments play an important, but passive, role in the initiation phase. Local governments participated in the initiation of the project in less than a fourth of the cases. But, they play a central role in the implementation of self-development efforts. Over half of the respondents cited city and/or town government for active promotion of a self-development project. More than a third of the projects involved a county government in the development of the project. Two-thirds of the projects involved other local government entities (school district, conservation district). Typically, once community support is gained for the project, the city government enters to provide resources or legitimation (as in serving as the recipient of a block grant).

Many government officials were reluctant to get directly involved in economic development. Although offering incentives to absentee-owned firms was generally acceptable, providing resources to existing businesses exposes local government officials to charges of prefer-

Figure 3  
Obstacles to implementing self-development strategies



ential treatment. For instance, a local revolving loan fund awards some applicants and not others. Few politicians are willing to take the heat from such a situation. This problem was resolved in Mankato, KS, when the city gave the decisionmaking power regarding its revolving loan fund to Mankato Commercial Development, a private business group. The city council retains veto power over the loan recommendations, though it has never exercised it.

Appropriate technical assistance from outside the community is crucial to successful self-development. Few small towns and rural communities possess the necessary expertise to implement self-development projects on their own. Our survey data indicate that local leaders relied on Federal, State, or regional agencies for important assistance in initiating self-development projects in nearly all of the projects. The outside agencies most relied on were a Small Business Development Center (cited by 28 percent of all respondents) and a regional or State specialist of the Cooperative Extension Service (26 percent). Personnel from regional planning commissions and from the State economic development agency ranked next.

The scale of activities needs to be kept at a workable size. Several self-development projects in our survey had grown too fast too soon. A great deal of pressure exists in rural communities for economic development projects to create as many jobs as possible to replace jobs recently lost. Communities need to maintain a balance between creating jobs and ensuring that the project develops a solid market for its goods and services, a reliable workforce with the required skills and experience, and experienced managers.

Pressure to expand, however, does not come exclusively from the communities. Funding sources are often biased against small projects because small projects require the same amount of administrative costs and supervision as do large projects. Federal and State governments, and private foundations too, are all often guilty of preferring large economic development projects. When small economic development projects do receive funding, they often face high administrative costs in complying with the same reporting standards as larger projects.

### Implications for Future Projects

Our survey results suggest several ways in which community-based economic development activities could be improved. Government and/or private institutions could be more helpful in three areas:

Communities would benefit from **technical assistance and information** that is more closely related to the needs of self-development efforts, especially in regard

to developing business plans, locating sources of financing, and writing grant proposals. But such assistance should be provided in a way that enables community members to maintain control of their project. Communities tend to rely too heavily on outside assistance, thus failing to fully develop local entrepreneurial skills that would be valuable in future development projects.

Technical assistance could also help in selecting a suitable organizational structure for the project. Organizational structure has important consequences for how the activity is managed and how it raises capital. Some options include for-profit corporations, cooperatives, or nonprofit organizations. Community organizations need assistance in understanding the role, responsibilities, and limitations of the organizational structure that is chosen.

Secondary-level organizations are needed to provide integrated technical assistance, assist firms or communities to network with another, and if necessary, act as a broker in obtaining small production loans. NES-DECC in South Dakota and ACEnet in southeastern Ohio are excellent examples of such organizations (see "Examples of Self-Development Projects," pp. 14-15).

**Access to credit** is especially important. States have implemented various policies to improve access to credit for self-development efforts. Several States have adopted a quid pro quo policy, which links bank powers to CRA (Community Reinvestment Act) activity. Banks with a good CRA rating are permitted to become involved in a wider range of activities than those with a lower CRA rating. Another strategy is to link deposits of State funds to CRA ratings. Other States have developed seed capital and venture capital programs to complement existing lending institutions. Most of these community-oriented programs attempt to reduce the risk of lending by pooling the risk. CRA activity may be linked to self-development efforts in rural communities by creating new pools of capital for innovative community-based projects.

At the local level, we found local revolving loan funds to be an effective strategy for increasing the availability of credit in rural communities. One particularly innovative approach is the Rural Enterprise Assistance Project (REAP) at the Center for Rural Affairs in Walthill, Nebraska. The project establishes member-based associations of small, startup, and would-be business owners; loans are made and serviced at monthly meetings, along with business training and networking.

**Plant closing legislation** could help other communities avoid the devastation reported by many of the communities in our survey caused by a recent plant closing. Such legislation could take several forms. First, "claw-

## Examples of Self-Development Projects

After conducting our initial inventory of potential self-development projects, we grouped the projects into several categories. A popular community-based development strategy is the **promotion of tourism and cultural activities**. These activities often draw on the cultural heritage of the region or specific skills and talents available in the community. One such project is the Annual Piedmont Summer Berry Festival in Dobson, North Carolina. First held in July 1987, the festival promotes and markets northwest Piedmont-grown blackberries, blueberries, and raspberries. The festival has generated 56 jobs for arts and crafts exhibitors and 14 jobs for growers.

As communities have begun looking to economic development strategies that go beyond industrial recruitment, the existing business sector has become much more important. Most of these efforts at **business retention and expansion** are rather informal and unstructured. In Valley City, North Dakota, volunteers interviewed 88 business proprietors about their business needs. They estimate that 37 jobs were either retained or created through assisting businesses.

**Locally controlled industrial development projects** typically focus on the creation of new businesses that are entirely under local control. The Appalachian Center for Economic Networks (ACEnet) is a nonprofit organization that links existing businesses for the development of flexible manufacturing networks (FMN's). ACEnet's pilot FMN project is the manufacture of wheelchair-accessible kitchen components. A for-profit firm coordinates the manufacturing of the components by a group of existing small firms. Marketing is handled by additional networks that include housing developers, architects, and building contractors. The role of ACEnet itself is that of education, overall networking, and grant getting.

During the 1980's, many rural communities found that **historic renovation or preservation** could stimulate the local economy. In Winger, MN, the city purchased the old Soo Line Railroad Depot from the State for \$50. The depot was moved to a park in town, the county contributed \$7,000 to construct rest rooms, and the Soo Line offered a \$5,000 grant and \$2,500 in matching funds to the city. The restored Depot now houses a community-owned cafe and an ice cream parlor that is managed locally.

Another economic development tool that has emerged over the past decade is the provision of business services through **small business incubators and small business assistance centers**. The Atmore (AL) Small Business Incubator, for example, provides assistance to new businesses in the form of office space at reduced rents, shared services and equipment, and equal access to a wide range of professional, technical, and financial services.

Several **community-owned firms** were identified in our study, including the Community Store, Inc. in Frederick, South Dakota. In 1984, the owner of the Frederick grocery store could not sell his business and was ready to close the doors. The community, not wanting to lose its only grocery store, held public meetings and began fundraising. A for-profit corporation was formed, with approximately 200 people (out of a total population of 320) contributing \$36,000 to purchase the building and inventory.

**Value-added activities** are most appropriate in localities where resources (such as agricultural and forest products) are extracted locally and shipped elsewhere for processing. Minnesota Corn Processing (MCP) in southwestern Minnesota was initiated by farmers interested in owning a processing mill

back" laws, which demand a return of public subsidies from companies that relocate during the life of the subsidies, could be used to promote self-development activities. These funds could be used to set up a loan fund for home-grown industry. A second possibility is public policy tradeoffs that require specific actions by private industry in exchange for public subsidies. For example, policies requiring advanced notice of plant closings would be very important for rural communities. Advanced notice is necessary to plan for the shock to the local economy and to attempt to create new jobs quickly to replace those lost.

### Conclusions

Self-development cannot be the primary economic development strategy for most rural communities. The number of jobs created or saved and the amount of income generated in the community from rural self-development efforts is modest at best. Self-development projects, however, also make noneconomic contributions to the community or region. Decisions about local economic development are made by a broader range of people than with industrial recruitment,

where local involvement is usually limited to a small minority of residents.

A second benefit of self-development is an increased sense of community among residents. Active involvement in the self-development effort often led to other collective efforts, such as efforts to improve the educational system or community social services.

An indirect benefit of self-development is that it may help prevent some of the more entrepreneurial, energetic members of a community from leaving. By providing stronger community support for these activities, self-development communities may enable entrepreneurs to find a niche in a local economy.

Finally, self-development also contributes to community economic stability by making the local economy less vulnerable to sudden shifts in markets or production technology. Local ownership, which conveys greater control over some of the community's key jobs, encourages more local investment and generates more jobs for local people.

and marketing their produce to their own mill. The wet-milling plant that was built produces corn starch, corn syrup, and ethanol alcohol, among other corn products. The project was funded with \$25 million in individual investments, \$30 million in loans from the Bank for Cooperatives, and \$1.6 million in tax increment financing from the town of Marshall. Approximately 100 jobs were created in the region.

**Worker-owned enterprises** are promoted increasingly as a response to the economic restructuring occurring in rural areas. This form of organization is particularly suitable for pooling and selling locally made arts and crafts. Mountain Skil-Crafts is a marketing cooperative in rural North Carolina with about 100 members who produce handcrafted items such as quilts, baskets, and toys. Individual crafters price their goods, and the cooperative then adds 35 percent to cover shop overhead. A committee screens the products to ensure they qualify as crafts. The cooperative provides employment opportunities and income in a very rural depressed economy.

There are several examples of **community-oriented finance institutions** in rural areas. NESDECC, the Northeast South Dakota Energy Conservation Corporation, is a community development corporation. (A CDC is an organization that can act as a venture capitalist, take equity interest in businesses it lends to, and participate in higher risk projects than banks can.) NESDECC provides financial and management assistance to small or part-time businesses run by low-income entrepreneurs in 22 South Dakota counties. It manages a revolving loan fund and over the past decade has served as an incubator for the development of five new businesses. These businesses were initiated under the umbrella of NESDECC and, once viable, are sold to a local potential

entrepreneur. In 11 years, 137 businesses were assisted with 193 loans, generating an average of 4 jobs per business. The average size of a NESDECC loan in 1990 was only \$7,000. NESDECC loans are made in conjunction with commercial bank loans, with NESDECC assisting the client with the cash-flow based business plan. Repayment rates to NESDECC have been 97 percent.

**Agricultural marketing organizations** are capable of overcoming some of the marketing disadvantages that small farms face. For example, low prices for wild rice, along with a generally poor economy in northern Minnesota, led to the formation of a three-county organization to grow, process, and market cool season vegetables for a niche market. Approximately 20 jobs have been created at the processing facility and on the farms.

**Community-based service firms** are public-private entities that are created to meet local needs for services, such as health facilities or cable television systems. The Kingman County (KS) Retirement Association is a community-based project that constructed a 60-bed nursing home that incorporates six assisted-care apartments. Through local contributions and the passing of a bond issue, enough money was raised to make the project a reality. Three months after completion, occupancy rates were ahead of initial projections—the six apartments and 30 of the 60 nursing home beds were occupied. The home includes an old-fashioned ice cream and popcorn parlor where visitors and residents can meet in a nonhospital-like setting.

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