Social capital as a club good: the case of ethnic communities and entrepreneurship

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Abstract

Purpose – The purpose of this paper is to offer the economic theory of clubs as a potential unifying paradigm for the study of ethnic economies and social capital.

Design/methodology/approach – The paper examines the basic concepts of club theory, and reviews the empirical literature. It then applies club theory to the notion of social capital within the context of ethnic communities. It is argued that although various sociological frameworks of social capital and social networks have provided powerful descriptive models of ethnic and immigrant population behaviors, social capital needs to be examined from an economic perspective to increase prescriptive capabilities.

Findings – Using club theory the paper conceptualizes the benefits derived from an ethnic grouping – among which social capital can be considered the most important – as a "club" good, supplied at the co-ethnic level and demanded by the various key stakeholders within an ethnic community. While these benefits are at least partially non-rivalrous, they have clear characteristics of excludability and therefore form a "pseudo-public" good. Four propositions are then offered regarding the behavior of ethnic entrepreneurs who draw from these important ethnic resources.

Originality/value – This paper offers a new way to examine social capital within ethnic communities. It also provides an economic foundation to begin analyzing optimal economic and social structures within these communities.

Keywords Social capital, Ethnic groups, Entrepreneurialism

Paper type Conceptual paper

Introduction

Starting with Piore's (1979) work on ethnic economies, sociologists and entrepreneurship theorists have focused on a number of underlying factors that appear to partially explain, or at least contribute to the explanation of, the coalescing characteristics of ethnic populations and entrepreneurs and the formation of ethnic communities. Within this body of literature, explanations of behavior inevitably involve discussions of social capital, social embeddedness and network ties (Portes and Sensenbrenner, 1993; Portes and Landolt, 1996, 2000; Portes, 1998; Kloosterman and Rath, 2001; Rath, 2002). Recently, there has been increased focus on understanding the dynamics of ethnic economies and how, over time, their economic engines are tied to other social, religious, cultural, and governance factors that ultimately frame the nature of an ethnic community. This interest in the dynamics of ethnic community formation and development has fueled a number of research paths, including fine tuning the definitional distinctions between levels of co-ethnic cohesiveness, such as ethnic neighborhoods, ethnic economies, and ethnic enclaves (Waldinger, 1982; Waldinger *et al.*, 1990; Light and Gold, 2000), directly examining the evolution of economic transactions among early and later stage ethnic

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entrepreneurs (Greene, 1997; Galbraith *et al.*, 2003), and investigating the role of religious and social institutions in capital, human, and intellectual transfer during different periods of an ethnic community's development (Kwon, 1997; Martes and Rodriguez, 2004; Galbraith *et al.*, 2004).

In spite of the proliferation of recent research on ethnic economies, what appears to be missing is an underlying and unifying theoretical paradigm. While recognizing that there are perhaps several possible theoretical candidates, we offer the economic theory of clubs (Buchanan, 1965; Ng, 1973; Berglas, 1976; Sandler and Tschirhart, 1980) as a potential unifying paradigm for the study of ethnic economies and the behavior of ethnic entrepreneurs. Within this context we conceptualize the benefits derived from an ethnic grouping – for example, higher levels of social capital, increased trust, reduced transaction costs – as a "club" good, supplied at the co-ethnic level and demanded by the various key stakeholders within an ethnic community. While these benefits are at least partially non-rivalrous, they have clear characteristics of excludability and can require the absorption of some costs associated with membership in the ethnic community.

Economic theory of clubs

Modern discussions of economic clubs have their theoretical roots in Tiebout's (1956) seminal 1956 paper on local public goods. In this paper, Tiebout responded to an earlier paper by Samuelson (1954) by arguing that the marginal efficiency of pure public goods violates the characteristics of market efficiency. Samuelson, taking a social justice perspective, had previously argued for larger municipalities populated with a myriad of government agencies that offer broad social, educational, and economic programs while aggressively intervening to manage the multiple externalities associated with differential taxing schemes and "free-riders." This general "social justice" approach was particularly attractive in the post-World War II industrial growth environment, providing much of the theoretical justification for the development of the 1950s and 1960s "megatropolises" such as Los Angeles, Houston, and Atlanta as well as the more recent trend of municipal consolidations and annexations (Huck, 2004).

Tiebout, however, invoking the now classic argument of "voting with one's feet" showed that a *quasi-spatial* adjustment mechanism could, under certain assumptions, lead to an efficient equilibrium or Pareto optimality for local public goods[1]. Thus, individual households, each attempting to maximize their own utility functions, will tend to congregate with similar households in geographical areas where local jurisdictions offer cost-competitive public goods that cater to those particular preferences. This should result in smaller, more homogeneous municipal constructs. As Heikkila (1996, p. 205) observes, "an irresistible metaphor is a giant shopping mall with countless 'municipality boutiques' offering specialized products or services for a well-defined clientele". Households, upon completing a search process, then select the municipal boutique that best satisfies their vector of preferences and needs. Voting with one's feet then leads to agglomeration around various vectors of local public goods offered by geographical different municipalities. In essence, Tiebout offered a counter point to the diversified, consolidated city and is often viewed as providing the essential explanatory model behind the other modern urban trend, that is, the proliferation of distinctly more homogenous, suburban bedroom communities (Le Goix, 2003).

Over time, the general Tiebout model of municipal goods has been gradually subsumed under a broader class of economic models known as club theory (Buchanan, 1965; Cornes and Sandler, 1996). Club theory, as broadly defined by Hochman *et al.* (1995), is concerned about the formation and characteristics of optimal production and consumption groups, and their sustainability under various competitive conditions. This definition subsequently broadened the analysis beyond the core municipality to include specific institutions that provide some form of public goods, such as school, water, and fire districts (Sterbenz and Sandler, 1992; Rosen and Sexton, 1993; Frey and Eichenberger, 1996). Over the years, a number of different issues and directions have been examined within the general theoretical paradigm of clubs, including relaxing many of the restrictive Tiebout assumptions (Padon, 1999), advances in Pareto optimality (Ng, 1973; Brennan and Flowers, 1980), sharing between clubs (Sterbenz and Sandler, 1992), the conditions under which optimal club membership is mixed (Berglas, 1976; Brueckner and Lee, 1988; McGuire, 1991), and the effects of differences in the club agents' abilities (Conley and Wooders, 2001).

Clearly there are parallels between club theory and both neo-classical theories on diversified, multi-product firms (Brueckner and Lee, 1988) and consumer preference theories that examine the relationships between segmented customer-markets and product positioning within a multi-dimensional perceptual space. Even Tiebout (1956) noted that spatial mobility provides the local public-goods counterpart to the private market's shopping trip. Thus, under conditions of general efficiency, households will always reveal their particular vector of preferences by the process of agglomeration around various differentiable local public goods and tax packages. This notion of "revealed preferences" by a person's or household's actions underpins much of club theory, and becomes an important element in understanding the formation of ethnic communities.

In addition to the obvious municipal services and local jurisdictional issues discussed above (see Dowding *et al.*, 1994 for a review of empirical research), club theory has also been used as the theoretical grounding for understanding the formation, composition, and pricing for a variety of "groupings" including recreational clubs (Hearne, 1988), adoption of voluntary codes of conduct (Prakash, 2000), adoption of ISO rules (Kollman and Prakash, 2002), the survival of international trade organizations (Fratianni and Pattison, 2001), optimum organization for farming co-operatives (Slangen, 1994), and political institution formation and voting behaviors (Kollman *et al.*, 1997; Perroni and Scharf, 2001). The key to understanding these broader applications of club theory lies primarily in understanding a broader definition of a "club good" those goods that are non-rivalrous (at least until the point where congestion reduces their benefits) and excludable. In the next section, we argue that one of the foundational concepts underlying ethnic economies – social capital – can, in fact, be properly considered a "club good."

Ethnic social capital as a club good

Over the past three decades, the concept of social capital has become one of the most enduring and important theoretical forces in explaining the social and economic behavior of immigrant populations (Portes, 1998). Given its roots in the sociological literature, social capital is traditionally defined as an asset, resource, or capability that arises from trust, reciprocity, goodwill, and knowledge among a well defined network of relationships (Woolcock, 1998). Two elements of social capital are critical: the complex vector of social capital assets and the social network that allows an individual or firm to locate, utilize and build upon these social capital assets (Coleman, 1988; Burt, 1992; Fukuyama, 1995; Portes, 1998). From a sociological perspective, sharing a common language, interacting with a common set of customs, and developing market exchange using common, and perhaps non-written, procedures help create a higher level of trust and access to information through the ethnic network. From an organizational economics perspective (Williamson, 1975), these components of social capital can reduce the transaction costs of contractual economic exchange – search time for appropriate economic partners is shortened, contracting and re-contracting costs are reduced, and enforcement efforts in the face of potential opportunistic behavior are lessened. In fact, from this transaction economic perspective alone, one would expect a greater degree of intra-ethnic vertical supplier-buyer relationships (Galbraith *et al.*, 2003) as well as synergistic horizontal partnering (Teece, 1980) as immigrants find efficient co-ethnic market and co-ethnic organizational-based solutions by accessing social capital[2].

While social capital is usually presented in the literature as a resource, recently it is being framed more as an "economic good" with defined benefits and costs (Portes and Landolt, 1996, 2000; Knack and Keefer, 1997; Portes, 1998). From a macro perspective, potential costs are "free rider" costs, where latecomers to an ethnic network benefit from the accumulated social capital without having to "pay" for the benefit. From a micro perspective, individuals may, for example, be expected to give discounts, free service or preferential treatment to other co-ethnics. Within this light, Fukuyama (2001) frames the basic theoretical point by noting that social capital is essentially a private economic good, i.e. a resource with a rivalrous and excludable nature, which has various associated economic "externalities."

The notion of externalities associated with social capital, we believe, is critical to understanding the nature of the social capital "good" with the framework of ethnic communities. And within this context, we argue that the rise of externalities also gives rise to the possibility of institutionalizing the property rights associated with the underlying asset. This argument builds upon Demsetz (1967, p. 350) who, noting the close relationship of property rights to the concept of externalities, writes "property rights develop to internalize externalities when the gains of internalization become larger than the cost of internalization". Property rights, in fact, are one of the most important instruments of societal and economic development (North, 1990; DeSoto, 2000; Dabla-Norris and Freeman, 2004). If social capital is considered an "economic good" then a form of property right must also be applied to the good if the externalities – positive or negative – become too great, particularly if social capital is a "private good" as suggested by Fukuyama (2001). To Demsetz (1967, p. 347) these property rights are the mechanisms that assist people to "form those expectations which (they) can reasonably hold in their dealings with others".

The view of social capital as an economic good fits well within the framework of club theory. Within this context, we therefore theoretically conceptualize the benefits derived from co-ethnic networks in the form of social capital as representative of a "club" good. This club good of social capital is supplied at the co-ethnic level via the network within the ethnic population, and demanded (and ultimately consumed) by the various key stakeholders within an ethnic neighborhood, economy or enclave such as the co-ethnic laborers, immigrant small business owners, and leaders of the ethnic community, depending on the level of analysis. In this light, social capital, regardless of its various sociological sources (Portes and Sensenbrenner, 1993), is seen as a collective asset supplied at the co-ethnic "network" level, derived from the sharing of the club's production costs (contributing to ethnic causes, etc.) and the commonality of the co-ethnic member's characteristics. Also, considering that individuals outside the ethnic community may have limited access to some of the benefits derived from social capital that is "owned" by the community (due to differences in language and culture, for example) and that even some community members can eventually be prevented from sharing those benefits (e.g. via the exclusion from ethnic social networks as a form of "punishment" for sub-par "contribution" to the development of the network or by being late arrivals, and thus "outsiders" to an established community), there is an evident nature of excludability in social capital, making it a classic "club" good.

Ethnic economies, entrepreneurship and club theory

Under the general Tiebout club hypothesis, assuming fixed costs and equal distribution of skills within the population, then people and/or households of similar tastes and preferences will partition themselves into non-overlapping jurisdictions, that is, they will form "clubs." This homogeneity characteristic is one of the most examined and tested of all the club hypotheses (Sandler and Tschirhart, 1980; Kelleher and Lowery, 2002) and there is growing empirical evidence to support this general argument (Dowding *et al.*, 1994; Heikkila, 1996).

This underlying Tieboutian homogeneity hypothesis of club theory appears to have immediate intuitive application when examining the formation and characteristics of an ethnic economy. Classic discussions of ethnic communities, after all, almost always suggest that a coalescing component of co-ethnics is that they share a common vector of preferences, endowments, and cultural beliefs and that these are visibly distinct from the general population. Thus, within the nomenclature of club theory, an ethnic community can be described essentially as a voluntary group of co-ethnics deriving mutual benefit from sharing production costs, co-ethnic members' characteristics and/or excludable goods. The various benefits derived from membership in co-ethnic networks, such as accumulated social capital, can be considered a local "club" good that is supplied at the co-ethnic grouping level.

Although large-scale empirical studies of the Tiebout homogeneity hypothesis have not viewed ethnicity and language as the main component of economic club membership, they have typically employed these elements as input factors along with other socio-economic variables such as income, occupation, and education. As expected, ethnicity does typically provide an explanatory component of intra-jurisdictional homogeneity and inter-jurisdictional heterogeneity. Heikkila (1996, p. 223) notes, for example, that "membership in 'municipal clubs' helps to explain variance along four dimensions: urban scale, ethnicity, household type, and economic class".

While ethnicity offers some explanatory power in regional agglomeration as noted above, studies of voting behaviors and municipal formation suggest that income and land-use preferences, not ethnic or racial diversity/homogeneity, tend to be the primary motivators of jurisdictional formation (Musso, 2001). Thus, while club theory suggests a "sorting" process among a diverse population to form more homogeneous sub-communities, it appears that the sorting process involving co-ethnic social capital, preferences, and consumption patterns, may not be completely location-specific. And while housing and income factors certainly cause some ethnic population agglomeration, the core ethnic economies and entrepreneurial behaviors may, in fact, be more "supra-regional" in nature.

In fact, clubs, including those described as ethnic economies, will never be completely homogeneous. There are always differences in potential club members' preferences and utility functions, as well as differences in the production of a club "good." In theory these differences can lead to less homogenous clubs (Berglas, 1976; Brueckner and Lee, 1989; McGuire, 1991) that are still optimal solutions, as well as over-lapping clubs (Frey and Eichenberger, 1996) and core homogeneity with diffused edges (Conley and Wooders, 2001). Club formation is almost always a cost-benefit process. As McGuire (1991, p. 1391) writes, "the crucial tension governing group composition remains a conflict between the disadvantage dissimilar people find from cooperating in a collective consumption and the advantage they find from cooperating in production".

From a business perspective, consider the economic relationships between suppliers and buyers within an ethnic enclave or economy. Here, the ethnic "club" is formed within an abstract multi-dimensional economic space, with the various ethnic businesses as club members. The results of the club good represent the benefits from intra-enclave trade, including lower labor costs associated with employing co-ethnic workers and the lower transactions costs of intra-enclave contracting. The "price" of club membership can come in different forms: higher input and product costs (Martes, 2000), various types of requests from other club members (e.g. discounts, hiring of relatives, preferential purchases, etc.), as well as "leveling pressures" or conformity requirements of the type described in Portes (1998). In a sense, if the strength of the within-club ties is based upon antagonism to another group (co-ethnic or not), the between-group relations are likely to become weaker. In the extreme, reciprocally hostile groups may become severely constrained in their potential for economic and cultural exchange, thus preventing ethnic entrepreneurs from accessing larger markets. In this case, the price of club membership could eventually be thought to be excessive.

Propositions and discussion

With this background, we offer four propositions regarding ethnic economies and entrepreneurial behavior employing an economic club theoretic framework. Two empirical studies will be discussed to provide empirical support to two of the propositions. One study involves measuring the intra-enclave economic exchanges of Hispanic and Arab ethnic entrepreneurs in Paterson, NJ (Galbraith *et al.*, 2003) and the other study traces the founding and development of an Hispanic ethnic economy and its associated social institutions in Wilmington, NC, from 1992 to 2004 (Galbraith *et al.*, 2004). While both studies should be viewed as preliminary, they do provide an opportunity to frame our discussions of ethnic entrepreneurship within the context of club theory.

Ethnic social capital and the development of ethnic businesses

Social capital, as a club good, must be seen as a collective asset that is supplied at the co-ethnic network level. Its value stems from a number of sources including the sharing of production costs, such as co-ethnics contributing to ethnic causes, festivals, and work training events, as well as the unique group characteristics, e.g. common language, culture, or immigration experience, that result in excludable benefits for non-ethnics.

Clearly social capital has value, and should encourage co-ethnic economic exchanges, contracts, and institutional solutions. However, evidence of ethnic business development appears to indicate that the process is dynamic, with diminishing returns to social capital as a business matures (Iyer and Shapiro, 1999).

This might suggest more of an evolutionary model of ethnic entrepreneurial behavior, in which potential immigrant entrepreneurs enter an ethnic community seeking employment, then accumulate resources and progress into a start-up phase that relies primarily upon intra-ethnic business ties, which in turn matures into a third stage of extra-ethnic market expansion (Morris, 2001; Sequeira and Rasheed, 2004). Early stage ethnic entrepreneurs are better able to develop strong ties with suppliers and co-ethnic customers and obtain the necessary work force at lower costs. Business growth, however, often requires expansion outside the community; or as Woolcock (1998, p. 175) argues, "the initial benefits of intensive intra-community integration must give way over time to extensive extra-community linkages".

As a corollary, it could be said that:

P1. Social capital related to ethnic business is, in fact, a club good but a club good that is limited in scale and as a result shows diminishing returns.

For example, utilizing an input-output analysis of goods and services for entrepreneurs belonging to two different ethnic enclaves in Paterson, NJ (Arab and Hispanic) we found that early stage ethnic entrepreneurs purchased from, and sold their products to, co-ethnics significantly more often than more established ethnic entrepreneurs; that is, the degree of importance of intra-enclave trade for the sustainability of an emergent business decreased as the business matured (Galbraith *et al.*, 2003). For both sub-samples, in every category of material inputs, labor inputs, service inputs and outputs, the percentage of co-ethnic economic exchange declined for more established businesses.

The maturity of ethnic businesses and club membership

Another explanation for this evolutionary entrepreneurial behavior can also be provided within the context of club theory. This suggests that the utility function of early stage ethnic entrepreneurs tends to be more similar to the general co-ethnic community's than later stage ethnic entrepreneurs. Several factors could cause this, including:

- lower levels of broad assimilation by new immigrants – making them more dependent upon the ethnic community;
- higher levels of wealth and other endowments by more tenured entrepreneurs, compared to the standards of the ethnic group; and
- the fact that in many ethnic communities early entry immigrants are often from the same geographic region within their home country.

If we considered the ethnic economy to be a "club," we would, indeed, expect some heterogeneity in the "ethnic club," with emergent entrepreneurs sharing more economic activity internal to the club than more established entrepreneurs, and the latter becoming more involved in "overlapping" clubs – a co-ethnic economy combined with a non-co-ethnic (or other-ethnic) economy, representing increasing levels of assimilation. In fact, assimilation within this context may be framed as the relationship of evolving personal utility and preference functions with the perceived benefits of resources derived from co-ethnic social capital.

In addition, ethnic markets are essentially small and as such will prevent ethnic businesses from achieving cost-efficiency in sectors where economies of scale are the basis of competition – in essence, the cost/benefit function of club membership changes as an ethnic business grows. This encourages, as McGuire (1991) argues, a more differentiated club. For these reasons, we would expect that mature ethnic businesses would progress towards lower dependency from intra-enclave trade, both in their purchases of inputs and sales of outputs. Under the light of club theory, this evolutionary pattern should not be surprising, and in fact, may provide for an optimal efficient solution of maximization of social welfare for the ethnic economy as a whole.

Thus:

P2. The partial assimilation of older, more tenured ethnic business people in society results in a more heterogeneous set of preferences and utility functions, which in turn results in overlapping economic "clubs" for these entrepreneurs.

Ethnic social capital as a quasi-public *good*

The basic Tiebout model assumes that club goods are "local public goods," where the good, service or benefit is both "nonrivalrous" and "nonexcludable" (Ostrom and Ostrom, 1977; Prakash, 2000). Rivalry represents the dimension of limitability, with "nonrival" implying that the consumption or enjoyment of the good by an individual does not diminish the ability of others to enjoy the good. "Nonexcludibility" means that other members of society cannot be prevented from enjoying the good. Fukuyama (2001), however, appears to draw a distinction, and calls social capital a "private good." Note that within this usage, "public good" defines a type of good, service, or benefit, and not whether the public or private sector provides it.

In general, we lie in-between the traditional Tieboutian assumption of local "public goods" and Fukuyama's "private good" argument, and start with the view that social capital is more of a "quasi-public (ethnic) good." Here, we define *quasi-public* ethnic goods as goods, services, and other benefits that are "offered" to a particular segment of the community – the ethnic population – that members of the general or broader community are unable to access because of their different ethnicity and/or language. To use Ostrom and Ostrom's (1977) categorization, our *quasi-public* ethnic good is a class of "impure public goods" in that they are generally "non-rival" – or at least only partially rival – but are, indeed, like private goods, "excludable." In the case of social capital, since the benefits derived from ethnic community-membership have their source in sharing a common language, belief system, legal and business expectations, and cultural context, it is exactly those aspects that make them "excludable" from other non-ethnics – and possibly, as an ethnic economy matures, even excludable from other co-ethnics if, for example, congestion becomes an issue.

But the benefits derived from social capital are not free; there are both costs and externalities. The cost or "fee" for membership in this "ethnic club" might include such things as discounts or free services that are demanded by co-ethnics, purchasing of ethnic goods at higher prices than typically available outside the community (Martes, 2000), hiring co-ethnic employees that are perhaps less skilled, and requiring time or monetary contributions to various ethnic social and political causes. Other costs might be seen as the "stereotyping" cost derived from the close association with a discriminated ethnic group, or even the threat of exclusion from participating in the benefits of the ethnic club after investments or efforts to join have been made. In this sense, there could be situations where the benefits of social capital, due to congestion, lose their non-rivalrous nature.

As an economic good, there are also certain externalities associated with social capital. The most obvious is the free rider problem that arises from late entrants to the "club". After the networks have been established and the stock of co-ethnic social capital accumulated, new co-ethnic (and oftentimes some opportunistic non-co-ethnic) entrants may desire to enjoy the benefits of the club without having paid their "dues" in terms of, for example, services to the ethnic community that signal commitment to long-term membership.

This "late-entrant" free-rider issue is similar to the problem of the late nineteenth Century homesteaders in the Western US who, after the earlier cattlemen and railroaders risked their lives and wealth establishing a "club good" of free-range ranching, entered the region and demanded the best land (and often rustled free range cattle) without any payment to the "club" – inevitable conflicts arose as witnessed by the Wyoming range wars of the late 1800s. While the free rider problem related to social capital comes in different forms, it ultimately results in the same consequence as any free rider situation – late arrivals have little incentive to pay for access to potential benefits of community social capital without some form of centralized subsidy. This inevitably results in a "crowding" – or, in classic club theory terminology, congestion – effect, where every co-ethnic wants to enjoy maximum benefit from their right to access the pool of ethnic social capital, which, in turn, results in economic inefficiencies, and in some cases, even conflicts as established club members attempt to exclude new, "non-paying" arrivals.

Under the light of these arguments, we offer:

P3. Social capital is not a free good, but rather a *quasi-public* good, and thus subject to both costs and externalities.

The internalization of the externalities of social capital

In theory, the informal contractual agreement between the co-ethnic and the club that generates the club good (social capital) also allows the club good to be produced in quantities that are most efficient for consumption. But as the ethnic economy matures, the stock of accumulated social capital expands, and the influx of new entrants increases, the externality problem become more severe, and crowding occurs. As Demsetz (1967) argues, this will likely give rise to a regime of property rights associated with the economic good. Current "holders" of ethnic community social capital must be satisfied that new entrants will not reduce, or even threaten to reduce, the value of their existing holdings.

We posit that this incentive to internalize externalities in later stages of an ethnic economy development results in the proliferation of various private and non-profit institutional mechanisms such as specialized charities, church groups, social organizations, and training programs. Access to such associations or networks is controlled, and membership is typically on the basis of reference or introduction, sometimes the common element being church or professional association membership (Martes and Rodriguez, 2004). Since, there is usually not a readily available private competitive solution for the social capital tied to a particular ethnic grouping, these communities and their associated networks are generally not easily replicable – another classic characteristic of club goods (Buchanan, 1965). Ethnic communities, defined in a broad sense, are essentially monopolistic in nature. In this situation, the monopolistic "non-rival" pie can be further subdivided among the various associations in order to better manage the increasing cost of externalities while still maintaining monopolistic characteristics.

Confronted by the mounting externality problem, social capital can also convert to a "pseudo-public good". Padon (1999) defines a pseudo-public good as a privatized version of a public good when concentrated groups of individuals demand control over a good that is beginning to have high externalities. Pseudo-public goods can be used to explain the rise of privately developed communities with homeowners associations. In essence, the constituents establish a "shadow government," providing greater control over membership and costs, including the capability of raising admission costs for latecomers. This could be seen as a pseudo-public equivalent to public "zoning laws" a traditional issue in club theory.

We argue that ethnic social capital acts essentially in the same manner. As an ethnic community matures, "shadow governments" are established within the ethnic community that create a series of limiting conditions or access restrictions – older co-ethnic participants still enjoy the benefits of the club good, while new entrants pay more if they want to "play". The existence of these sub-local impure public goods, or *quasi-public* ethnic goods, thus creates pockets of homogeneous "privatized" clubs, each optimizing their consumers' preference criteria under a combination of jurisdiction-wide public ethnic goods and sub-jurisdictional *quasi-public* ethnic goods.

It follows that:

P4. As an ethnic economy matures, the increased externalities of social capital are progressively internalized as a form of "private property," controlled by *quasi-public* or pseudo-public institutions.

A longitudinal study of a Hispanic ethnic community in Southeastern North Carolina appears to support this argument (Galbraith *et al.*, 2004). In 1992, with a Hispanic population of less than a couple hundred, there was only one Hispanic-related social organization, the Catholic Social Ministries. During the next 12 years, the Hispanic population grew to several thousand and by 2004 there were over 15 specialized social organizations, each controlled by a well-established hierarchy of co-ethnic members, most of whom had been early immigrants into the community. These included, for example, a Hispanic Economic Development Corporation, a Hispanic Chamber of Commerce, Hispanic charities, Hispanic social organizations, Hispanic training and education groups, Hispanic health initiatives, and Hispanic political action groups. Each "club" provided a distinct and sometimes overlapping social benefit to the broader local Hispanic community, and most of these benefits were subsidized by charities or government grants as a form of capital transfer. Membership in the "shadow governments" that controlled these social organizations, however, was carefully protected and restricted, with almost no new entrants allowed, unless the new entrant offered to commit substantial human or capital resources. The traditional business and entrepreneurial benefits that accrue from social capital networks, such as business referrals, contract bids, and personal references and networking were closely regulated, sparingly awarded, and in any case always restricted within the constituency of the "shadow governments" for each association.

Final thoughts

While the original Tiebout model includes some fairly restrictive assumptions, such as full knowledge of differences in revenues and public goods offered by competing jurisdictions, consumers that are fully mobile, and a sufficient collection of competing communities (Oates, 1969; Epple *et al.*, 1978; Padon, 1999), we believe that it is useful to examine ethnic neighborhoods, economies, and enclaves within this context. Although theoretically attractive and capable of shedding light on various aspects of the dynamics of ethnic economies, the original Tiebout model cannot fully explain, for example, why the same jurisdiction (given the same housing stock, tax structure, etc.) may contain a collection of two or more distinct, and evidently sustainable ethnic enclaves, literally side-by-side, or why a single ethnic enclave might exist surrounded by a general population of non-co-ethnics within the same immediate area. Under the basic Tiebout model we would expect that each ethnic club would "vote with their feet," and seek out separate, more optimal jurisdictions such that the intra-jurisdiction population would be homogeneous, composed primarily of co-ethnics.

While a number of possible explanations can be offered, three seem most promising. First, perhaps "voting with one's feet," in the case of ethnic communities, is more a slow crawl than a fast run. There may be an overall tendency for ethnics to migrate to more fully homogeneous jurisdictions as the Tieboutian hypothesis might suggest, but this process is not without friction. There are mobility barriers, particularly with lower income populations (Dowding *et al.*, 1994; Bickers and Stein, 1998; Huck, 2004). Other types of barriers may exist at the confluence of the human capital possessed by individual immigrants with the level of social capital that exists in the ethnic networks (Greene and Chaganti, 2004). Enclaves do evolve, expand, combine with other ethnic agglomerations, and in some cases even assimilate into the larger host society, but this evolution tends to be relatively sticky; which in turn may result in sub-optimization of an ethnic club's bundle of preferences. Certain events can speed up the process, such as the violent attacks on the Korean community during the Los Angeles riots of 1992, but without this impetus enclave migration is generally slow, thus allowing other non-co-ethnic populations to expand near or around the ethnic enclave.

Second, the general Tieboutian model requires a complete search, with full information about the package of local public goods and taxes offered by various jurisdictions. However, when applying this idea to the development of ethnic communities there is a long line of research that suggests that people, in fact, follow a very limited search process in their immigration decisions. It is well documented, for example, that Mexican and Central American immigrants in US cities tend to immigrate by following family and friends to a particular location, often times returning to their native villages, then back to their host community (Piore, 1979). And in some cities a large number of immigrant residents are often found to be from only a few small villages in their native country (Galbraith *et al.*, 2004; Martes and Rodriguez, 2004). A potential immigrant from a rural village in Mexico, for example, probably does not investigate the characteristics of Hispanic communities in each and every

US city prior to "voting with his feet." Instead, he or she relies more upon word of mouth, familial ties, and convenience of transportation. This limited information search pattern is similar to that in consumer decision-making, where brand loyalties and limited search patterns mean that consumers will select the same product, such as beer or breakfast cereal, time and time again without seeking additional information about competitive, and perhaps more optimal, products.

Third, as we suggest in this paper, ethnic economies and enclaves may simply be much more complex than the regional jurisdictions often studied by urban economists. Whereas certain government-supplied public goods related to housing, employment, and health may be location specific and thus may suggest some physical agglomeration of co-ethnics, the benefits derived from social capital may be more "supra-locational" in nature, and thus tied more often to the "shadow" jurisdictions of ethnic-specific agencies, charities, and religious organizations that ultimately anchor a maturing ethnic economy. As a consequence, while the sticky nature of ethnic migration and limited search may produce sub-optimal results in terms of the use of the local public goods, the existence of supra-jurisdictional *quasi-public* ethnic goods offered by the "shadow" jurisdictions may still maintain a possible Pareto optimal solution.

This paper is written to suggest one possible unifying approach to understanding the formation of ethnic neighborhoods, economies, and enclaves, as well as the entrepreneurial behaviors within these ethnic groupings. By design, this paper was meant to be neither a definitive study of club theory nor inclusive in its application to ethnic and entrepreneurial issues. We also recognize that the theory of clubs overlaps with several economic, strategy, and marketing models, including the agglomeration theories of regional economics, central tendencies models in theoretical economics, strategic group theory in the strategic management literature, and consumer group and preference models in the marketing literature.

Over the past decades the various sociological frameworks of social capital and social networks have provided powerful descriptive models of ethnic and immigrant population behavior. However, the prescriptive power of these models is likely to benefit from the inclusion of an additional perspective, of a more economic nature. One important advantage to more economic and strategic approaches to understanding ethnic communities and entrepreneurial behavior is that these frameworks have not only a useful descriptive ability but also a normative, prescriptive capability to suggest avenues for optimizing economic development and entrepreneurial success. While the exact application of club theory to ethnic economies and entrepreneurial behavior remains to be examined in detail, the four propositions offered in this exploratory paper will hopefully stimulate the investigation of this potentially valuable avenue of research.

Notes

1. From Pareto (1848-1923), "Pareto Improvement" is an economic concept of social welfare improvement. Social welfare goes up if at least one person is made better off (in their own estimation) and no one else is made worse off. A Pareto optimum or efficient solution is reached when it is impossible to make one person better off, without making someone else worse off.
2. The relationship of social capital to the economics of both market and institutional solutions to economic exchange, vertical relationships, and scope economies within an ethnic economy has been touched on by several writers, but not fully explored as of yet.

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