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The Role of Cooperatives in the American Economy

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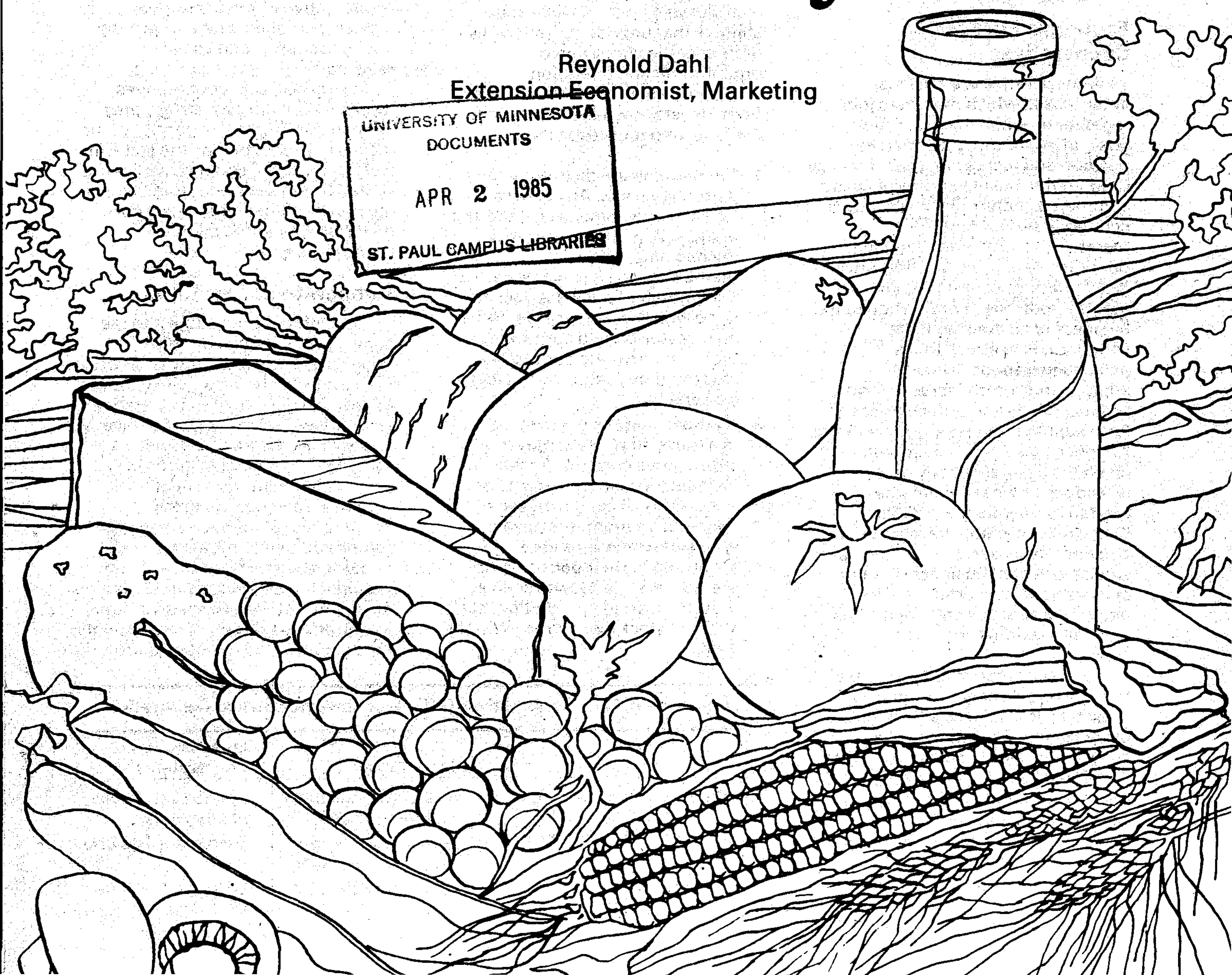


In recent years many questions have been raised about cooperatives and their role in our economy by those who do not understand what cooperatives are or how they operate. Let's look at cooperatives and their role in the American private enterprise system.

In exploring cooperatives we will seek to discover how they differ from investor-owned corporations, whether they pay taxes, the sectors of our economy in which cooperatives are located, their importance to the economy, and the economic benefits of cooperatives.

The emphasis here will be on agriculture since cooperatives have helped American family farmers achieve the most efficient food production system in the world. Our farmers provide U.S. consumers with a stable, high quality, low-cost food supply. Enough is left over for export to make farm exports a major contribution to U.S. foreign exchange earnings.

Economic Purpose of Cooperatives

A cooperative is a business enterprise in which members join together to achieve the common goals of improving their market position and increasing their income. Cooperative business enterprise is a commercial enterprise that renders economic service to its member-patrons. After deducting operating expenses, a cooperative distributes net earnings to its member-patrons in proportion to the business each does with the cooperative. In effect, these patronage refunds are price adjustments which increase farm product prices and reduce prices of farm supplies and services. Since the member-patrons of a cooperative receive the benefits, they must provide the owner capital (risk capital) to operate the business. Cooperatives enable farmers to own and operate a user or service-oriented business. Farmer ownership allows producers to determine services and operations that will maximize their own farming profits.

For a cooperative to be successful in achieving its economic goals it must be successful as a business organization. The success of a cooperative as a business is measured by the same criteria applied to other forms of business. Cooperatives must generate net earnings to build adequate owner capital. A portion of the patronage refunds made out of earnings is typically paid to member-patrons in cash with the balance allocated to them in non-cash equity which is usually revolved later. The principal way in which member-patrons supply owner capital to their cooperatives is through reinvestment of patronage refunds.

Cooperatives Differ From Investor-owned Corporations

Most cooperatives in the United States are incorporated like investor-owned corporations. When a corporation is formed it gains the status of a legal person in the eyes of the law. In effect, a corporation is an artificial being created by law to conduct a business. Ownership of a corporation is divided into shares that are called stock. Stockholders (the owners) of corporations have limited liability. They risk only the amount they have invested in stock purchases.

Cooperatives are like investor-owned corporations in that the shareholders have limited liability. But most cooperatives are incorporated under special state statutes that provide for several key differences in cooperative organization and operation.

Cooperative corporations differ from investor-owned corporations in the following four respects.

1. Net margins are distributed on a patronage basis. Any excess revenue over expenses at the end of the year in a cooperative is divided among the member-patrons in proportion to the amount of business each has done with the cooperative. But in an investor-owned corporation, that same revenue goes to the stockholders according to stock ownership.
2. Member-patrons exercise control in a more democratic way in a cooperative corporation than in an investor-owned corporation. Regardless of capital invested, cooperative members have one vote and sometimes vote according to their patronage in the cooperative. However, in an investor-owned corporation, each share of stock owned receives one vote.
3. Returns (dividends) to stock invested are limited, usually to 8 percent. There is no such limitation in an investor-owned corporation. Cooperatives emphasize returns to patronage rather than returns to capital invested.
4. The economic purpose of a cooperative is to maximize returns to its member-patrons in contrast to an investor-owned corporation which maximizes returns to its shareholders.

The key differences between cooperatives and investor-owned corporations are summarized in the table below.

Cooperatives Are Private Enterprises

Often the name "cooperative" is applied to organizations that are operated and controlled by the state in certain centrally-planned economies. These so-called "cooperatives" are, in reality, instruments of the state in carrying out its economic and social programs.

In contrast, U.S. cooperatives represent private ownership; they oppose ownership and control of the means of production by the state. In fact, members of cooperatives in the United States view cooperatives as a means of self-help that can reduce government participation in economic activity.

Cooperatives Pay Taxes

Cooperatives are subject to the same taxes imposed on other businesses. These include property, excise, sales, and income taxes. An essential objective of a cooperative is to furnish service at cost. Hence, a cooperative distributes its net earnings to member-patrons in proportion to the amount of business each does with the cooperative. Since such patronage refunds adjust member-patrons' prices to cost, a cooperative is not required to pay the corporate income tax on the net earnings it distributes as patronage refunds. Such amounts are income to the member-patron

Summary of How Cooperatives Differ From Investor-owned Corporations

	Cooperatives	Investor-Owned Corporations
Distribution of net earnings	On a patronage basis according to use	Distribution on basis of shares held
Control	Democratic control (1 vote per member)	Each share has one vote
Return on capital	Limited to 8 percent	Unlimited
Economic purpose	Maximize returns to member-patrons	Maximize returns to shareholders

who, in turn, pays the tax. This is referred to as "single tax" treatment.

Generally cooperatives retain a portion of the patronage refund instead of paying the entire amount in cash. The member-patron is notified of the retained refund and must pay income tax on the entire refund. Most cooperative tax rules are found in Subchapter T of the Internal Revenue Code. These rules are available to any business which chooses to operate on a cooperative basis—it need not be a farmer cooperative.

Cooperatives often earn income from sources other than business done with their patrons. Examples include interest earned on investments, rental income from leasing surplus property, and gains on the sale of property. This non-patronge income is taxable to the cooperative at regular corporate income tax rates. The after tax earnings are usually retained in unallocated reserves or retained earnings and become a part of the cooperative's permanent capital.

Cooperatives in Our Economy

Cooperatives are found in many sectors of our economy; they are, however, especially valuable to farmers. There are marketing, supply, and service cooperatives.

Marketing Cooperatives

Agricultural marketing cooperatives have a considerable impact on the farm economy. It is estimated that nearly 30 percent of all farm commodities are marketed through cooperatives. They are particularly important at the level of first sale by farmers and at the first level of processing of farm commodities.

Examples of large marketing cooperatives are given below:

Dairy
—Land O'Lakes, Inc.
—Mid-America Dairymen, Inc.
—AMPI (Associated Milk Producers, Inc.)

Grain
—Harvest States Cooperatives

Livestock and Poultry
—Central Livestock Association
—Farmers Union Marketing and Processing Association
—West Central Turkeys, Inc.
—North Central Wool Marketing Corporation

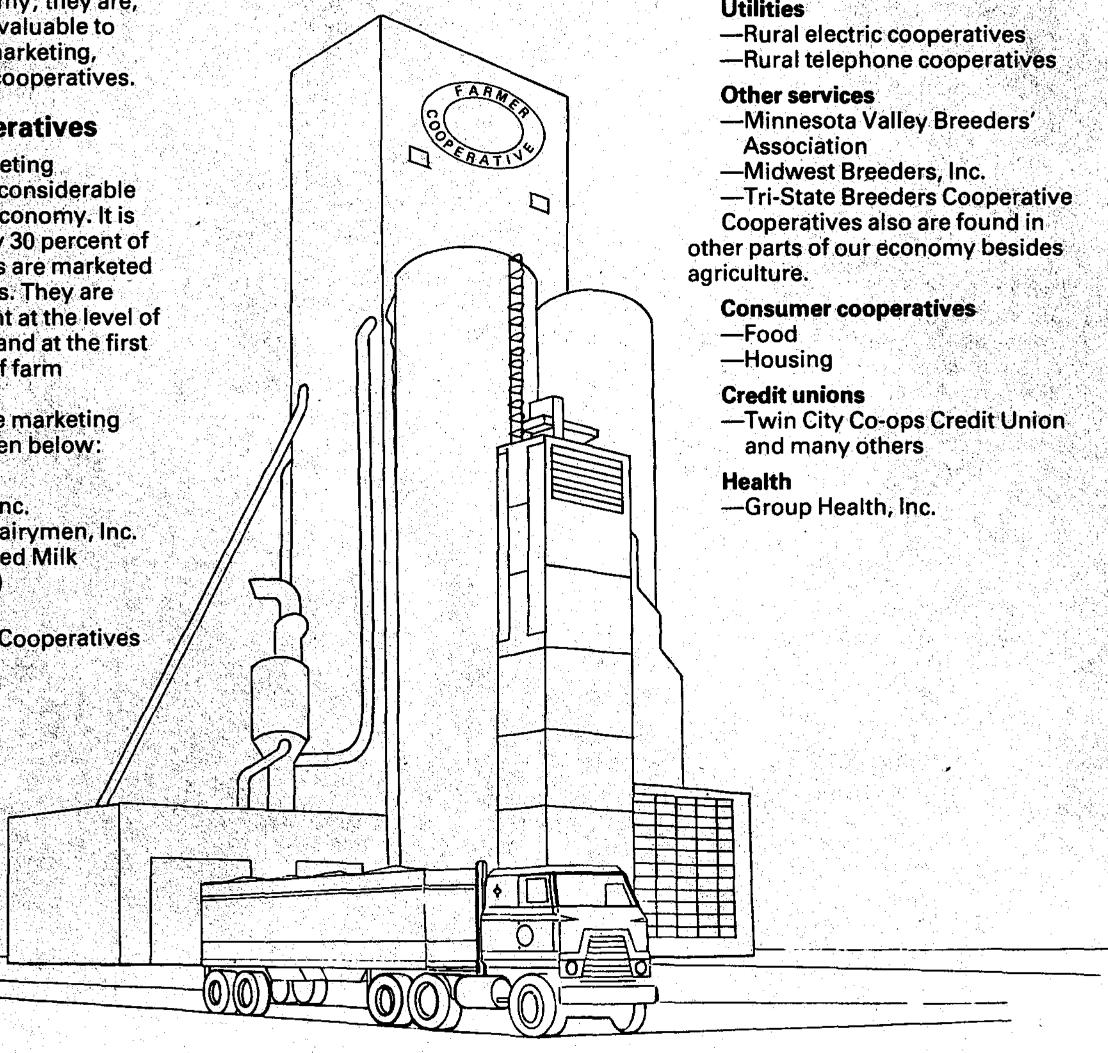
Sugar
—American Crystal Sugar Company
—Southern Minnesota Beet Sugar Cooperative

Supply Cooperatives

Almost one-fifth of the production supplies and equipment used by farmers is purchased through cooperatives. Examples of some of the larger farm supply cooperatives are:

—CENEX
—Farmland Industries

Interregional cooperatives include:
—CF Industries, Inc., which manufactures and distributes fertilizers to its member regional supply cooperatives that now handle almost 40 percent of the fertilizer purchased by farmers.
—Universal Cooperatives, Inc., which distributes tires, steel products, chemicals, etc., to its member regional farm supply cooperatives.



Service Cooperatives

Service cooperatives deal in such areas as finance, credit, insurance, and other services.

Finance and credit
—Farm Credit Services consists of the Federal Intermediate Credit Banks and the affiliated Production Credit Associations (PCAs), the Federal Land Banks and the affiliated Federal Land Bank Associations (FLBAs), and the Banks for Cooperatives. All are cooperatives and are owned by the farmers who use them.
—Farmers obtain more than 30 percent of their credit needs through cooperative lenders.

Insurance cooperatives
—MSI Insurance
—Mid-America Mutual Life Insurance Company
—Farmers township mutual insurance companies

Utilities
—Rural electric cooperatives
—Rural telephone cooperatives

Other services
—Minnesota Valley Breeders' Association
—Midwest Breeders, Inc.
—Tri-State Breeders Cooperative

Cooperatives also are found in other parts of our economy besides agriculture.

Consumer cooperatives
—Food
—Housing

Credit unions
—Twin City Co-ops Credit Union and many others

Health
—Group Health, Inc.

Economic Benefits of Cooperatives

We are frequently asked about the economic role of agricultural cooperatives in the United States economy. Many advances in farm production technology have increased farm size and efficiency over the last half century. Is the need for farmer cooperatives as great today as it was fifty years ago? Do consumers derive any benefits from farmer cooperatives?

Many economists would agree that cooperatives make several important economic contributions in our agricultural and food industries. Agriculture, despite its many changes and advances, is still a competitive industry characterized by a large number of small, producing units. Though technological change has increased size and decreased numbers of farms, and corporations have expanded in such areas as poultry, the bulk of our agricultural production still comes from individually operated family farms. A farmer acting alone lacks bargaining power both as a buyer and a seller. By organizing into cooperatives, farmers strengthen their bargaining power in the face of the larger organizations that buy their products and provide their supplies. So farmer cooperatives improve competition in farm product and farm supply markets.

Second, cooperatives make an important economic contribution in providing more and better marketing services needed by farmers. For example, cooperatives took the lead in providing formula-blended feeds and fertilizers to their members. Many marketing cooperatives engage in food processing, which enables farmers to obtain a larger share of what the consumer pays for food. And credit cooperatives, such as the Production Credit Associations and the Federal Land Banks, have been innovators in tailoring credit services and loan repayment programs to farmers' needs.

Finally, cooperatives assure their member-patrons a source of supply for vital farm necessities such as petroleum and fertilizers and a market outlet for their products. They have also benefited consumers through lower food prices by enhancing competition in the food marketplace.

Cooperative Size and Efficiency

Efficient competitors present a continuous challenge to cooperatives to render better service at lower costs. Reciprocal competitive action of efficient cooperatives and efficient non-cooperative business firms is a most desirable goal for our economy.

Critics of cooperatives argue that farmers' cooperatives have become too big. However, farmer cooperatives have had to grow along with non-cooperative business firms in the United States to achieve the lower costs associated with large-scale operations. Cooperatives have become larger as they performed more marketing services such as processing and packaging. Farm supply cooperatives must be large in order to refine crude oil and manufacture fertilizer. Farmer cooperatives are small relative to non-cooperative firms with which they compete.

Employment Opportunities

Many graduates of the College of Agriculture of the University of Minnesota obtain employment with cooperatives. The curriculum of Agricultural Business Administration, which is offered jointly by the College of Agriculture and the School of Management, is particularly well suited for students preparing themselves for employment with cooperatives.

Many students in agricultural economics and other fields in the College of Agriculture take a special course entitled Cooperatives and Agribusiness Organization, where they have an opportunity to study in-depth how cooperatives fit into the American economy.

Summary

Cooperatives are privately owned business firms that are an important, integral part of our American private enterprise system. They provide a means of complementing and strengthening our economy.

Although cooperatives are not a panacea for all of the ills of the American economy, they do perform a positive role in our private enterprise system by helping achieve a better allocation of resources and higher total production.

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