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Trends in Agricultural Cooperation

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Twenty-five years ago many of the leaders in the field of agricultural economics were devoting a considerable portion, if not all, of their attention to the field of agricultural cooperation.

The early literature contains important contributions by J. D. Black, E. F. Dunmeier, H. E. Erdman, B. H. Hibbard, W. E. Grimes, E. G. Nourse, Theodore Macklin, and others too numerous to mention. These same persons frequently advised and counselled with associations, then in their formative stages, which are today celebrating their 25th anniversary. To some they served as godfather or even as midwife. The precedent they established persists. As a matter of fact, there are few associations organized today that have not had the advice, counsel, or assistance of an agricultural economist--even though he may carry another title.

During this quarter of a century a number of factors have had a profound influence on farmers' business associations. Aside from the upheavals in the general economic environment which affected all business enterprises, governmental policy toward farmers' cooperatives has been the outstanding factor.

Congressional legislation establishing the Division of Cooperative Marketing, grants in aid to the Land Grant colleges, the Federal Farm Board, the Federal Land Banks, the Intermediate Credit Banks, the Production Credit System, the Banks for Cooperatives, the Cooperative Division of the Farm Security Administration, certain tax exemptions, and some exemptions from the Sherman Act are all landmarks to the agricultural cooperative system. Some of you who worked in the cooperative field two decades ago will recall that at that time

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/1 - A paper at the Western Farm Economics Conference, June 25, 1942, Palo Alto, California.

suits were brought against County Farm Advisors for the misuse of County funds when they assisted farmers in organizing cooperatives. What a contrast with the situation now! One may reasonably ask: "Why?"

If there is one single answer it is that cooperatives, when efficiently operated, benefit both producers and consumers by narrowing margins and improving services.

Throughout the 25-year period, however, there have been marked changes in philosophies and policies both within the movement and officially as to the economic function of cooperatives, particularly of marketing cooperatives.

The first philosophy is that cooperatives are developed to lower costs, to improve quality, to render better service, and to increase farmers' bargaining power.

The second philosophy is that cooperatives, by obtaining control of a large proportion of the total volume of a given commodity, can and should influence market prices to such an extent that most of the producers can make satisfactory profits.

The first attempts in cooperative activity were local in character, but as these grew in strength and number they exerted a profound influence on local margins and prices. From this experience a movement grew to enter the terminal markets to do something about wholesale prices. Terminal cooperative associations were bitterly fought and even boycotted by the trade but in the end established themselves successfully. They corrected many unethical trade practices, and where they had sufficient volume, demonstrated considerable bargaining power. This experience in turn led to the theory that if all or most of the volume of a given product were in the hands of a cooperative, prices could be controlled.

The control philosophy received considerable impetus in the early 20's

when the producers of the staple crops were suffering from sharp price declines, while the producers of numerous specialty crops were enjoying rather prosperous times. The fact that a number of the specialty crops were marketed by producers' associations with a considerable degree of control, with the members bound to the association by rigid contracts, was seized upon as the logical method to deal with the staple crops under the belief that such organizations could control prices.

Agricultural economists pointed out the fallacy of the underlying assumption but their advice was unheeded and the monopoly philosophy had its day. From Maine to Florida, from Texas to North Dakota, farmers were organized into large-scale potato, tobacco, cotton and wheat cooperatives. Their struggles are a matter of history. What confused many persons was that many specialty crops are sold in a monopolistic type of market rather than in a competitive market as are the staples. Opening prices for specialty crops are set by the board of directors and the managers of cooperatives, but prices are and must be set in line with supply and demand conditions if the crop is to move. Furthermore, as had been demonstrated, perishables can be more efficiently distributed throughout market areas under the direction of a single agency than by competitive shippers. Besides, associations of producers of specialty crops have been able to increase the demand for them through carefully planned advertising and trade promotion programs.

In spite of the failures of a number of the large-scale staple cooperatives, the philosophy of monopoly control for the staples persisted, and in 1929 when something just had to be done for agriculture, Congress established the Federal Farm Board, which crystallized the monopoly philosophy into law and gave the Farm Board funds to give it a trial. I know from discussions with some of the members of the Board that they had little faith in the program, but

they were directed to make the attempt so did their best to try it out.

Several large-scale national associations were formed, among them the Farmers National Grain Corporation, the National Fruit and Vegetable Marketing Association and the American Cotton Cooperative Association. Government funds were furnished in liberal amounts and real effort was made to avert the world-wide price declines.

But the cooperatives, even with liberal Government credit, could not stem the tide. What membership capital they had was soon depleted. They were given every assistance possible. The programs of the Board were worked through them. In fact, at one time there were two market prices for wheat, one through cooperative and the other through private channels at from 15 to 17 cents a bushel lower.

With the demise of the Farm Board and the assumption of its lending functions by the Farm Credit Administration in May, 1933, the era of monopoly cooperation officially came to an abrupt end.

This meant an about-face in the policies and procedure of many associations and the liquidation of a number of them. Back to the original philosophy of lower costs, improved quality and improved service they were forcibly turned. Some accepted it with reluctance and others with enthusiasm. The dying gasps of the large-scale nationals haunted Washington for a number of years -- but in the meantime from 1933 on, the rebuilding of cooperative enterprises began through the assistance of the state colleges, the Cooperative Research and Service Division of the Farm Credit Administration and the Banks for Cooperatives on the basis of membership capitalization and responsibility with limited objectives.

This was a significant reversal for the cooperative movement. During the heyday of the large-scale nationals, members or prospective members were often

informed: "When you endorse your check in payment for your product you become a member. If everything turns out satisfactorily you get a patronage dividend; if not, you will not lose because the association is supported financially by the Government." But since then, the Banks for Cooperatives tell members and prospective members, "You are expected to furnish between 40 and 50 per cent of the original capital necessary to finance the fixed assets, and from 20 to 50 per cent of the necessary working capital." In other words, they are asked to pass judgment on the feasibility of a cooperative enterprise through a substantial financial interest and to accept the responsibility for its management and control.

What has happened since then? It is almost a decade since the crescendo of monopoly cooperation reached its climax.

Since 1933 the number of cooperative marketing association in the United States has declined slightly. However, the number of members has increased slightly and the volume of business has increased considerably when measured in dollars but only slightly when measured in physical units. The last census shows that 13.6 per cent of all farms in the United States were selling through cooperatives in 1939, compared with 11.0 per cent in 1929. <sup>/2</sup>

On the other hand the cooperative purchasing of farm supplies has increased by leaps and bounds.

Not only did the number of associations classed as cooperative purchasing organizations increase but many of the marketing associations undertook the handling of farm supplies. The 1940 Census further shows that 12.2 per cent of all farms were buying supplies through cooperatives in 1939 compared with 6.5 per cent in 1929.

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<sup>/2</sup> - For detailed statistics on cooperative marketing see: Cooperative Marketing by Farmers. 1940 Yearbook of Agriculture, pp. 684-705.

Reliable estimates <sup>/3</sup> recently made indicate that the value of supplies purchased cooperatively by farmers in 1929 approximated 125 millions of dollars, while in 1940 the total was 375 millions of dollars.

The farm supply bill runs into big figures annually. For feed, fertilizer, farm machinery, trucks, tractors, automobiles and the expenses of operating automotive equipment, it approximates 2.5 billions of dollars. <sup>/4</sup>

A significant development in cooperative purchasing is the integration of activities among locals and even large-scale regional associations to the extent of developing sources of raw materials, manufacturing, and distributing them. For example, a large-scale regional cooperative purchasing association in the Middle West erected oil refineries and pipelines in 1939, and in 1940 formed a cooperative oil producing association which has brought in seven wells. Similarly, a number of associations have built feed mills, fertilizer factories and paint blending plants.

We may expect to see a continued rapid growth in the cooperative purchasing of farm supplies, first because numerous marketing associations are adding supply departments; second, because the experience gained by the existing associations is being coordinated through regional and national supply associations; and third, because the purchasing associations are now eligible to borrow through the Farm Credit Agencies for all purposes including the acquisition of facilities, which was not the case prior to 1935.

A third field of cooperative activity which has expanded rapidly in the last decade is that of farm business services. These include mutual fire insurance companies, mutual telephone companies, cooperative hauling associations, electrification associations, cotton ginneries, fruit and vegetable dehydrators,

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<sup>/3</sup> - Knapp, Joseph G. The Rise of Cooperative Purchasing. Paper before the American Institute of Cooperation, Athens, Georgia, Jan. 14, 1942. Mimeo.  
<sup>/4</sup> - Knapp, Joseph G. (Same as <sup>/3</sup> )



pest control associations and other similar special service cooperatives. Data are not available prior to 1939 on the extent of these activities. However, in that year the census of 1940 reports 11.7 per cent of all farms obtaining business services through cooperatives.

Mutual irrigation associations or water companies remain about stationary in volume of business, number of members and territory served. They are one of the oldest forms of cooperative activity among farmers -- many having operated for a period of 50 years or more and are among the most substantial and successful of farmers' organizations.

A fourth field of cooperative activity which has expanded rapidly is that of cooperative credit. The Federal Land Bank system showed an increase in loans outstanding from slightly more than one billion dollars in 1933 to more than two billions of dollars in 1935. The basic reasons therefor and the agricultural credit situation in general are well known to all of you. Recent developments and the statistics of the activity in cooperative credit, however, may be of some interest.

Since 1933 the financing of production credit through production credit associations has been established. These associations numbered 529 in 1940 with a volume of business totaling 350 millions of dollars in that year. They have done one of the most outstanding and constructive jobs in the business of agriculture. As a result of the activities of these associations many farmers in many areas for the first time were able to break loose from store or dealer credit with its excessive rates. At the same time, farmers were taught better business methods and farm management procedures through the association's insistence upon budgeting of operations and advancing funds to borrowers on the basis of the budget.

The Banks for Cooperatives extended credit to farmers' cooperative

marketing and purchasing associations and farm business service organizations in the amount of 126 millions of dollars in 1940. These Banks themselves have some cooperative features in that borrowers are required to own stock in the Bank in proportion to the amount of the loans they obtain -- depending on the type of loans. Also the borrowers elect one member to each of the twelve District Farm Credit Boards.

So much for the statistical trends.

Within the cooperative movement there are a number of trends that are worthy of comment.

The first is a marked increase in membership responsibility and understanding of their business. This has developed hand in hand with a substantial increase in the members' capital equities in their associations.

Second, the net worth of most associations has increased materially. This has been in no small part due to the Banks for Cooperatives' insistence that borrowers adopt a definite plan of capitalization and build an adequate capital structure.

Third, the business methods and procedures have shown a substantial improvement through the installation of adequate accounting systems and the procurement of comprehensive and analytical audit reports.

Next, the legal structure of numerous associations has been strengthened through amendments and in some cases complete reorganization. In many cases changes were necessary to comply with legislation affecting cooperative status. On the other hand, some associations made changes to assure control in the hands of patrons.

Finally, cooperative leaders have definitely directed the program of cooperative undertakings to the more conservative economic objectives of these enterprises. This is illustrated by the statements of various leaders in the

cooperative field. Dr. H. E. Babcock, President of the National Council of Farmers' Cooperatives, in a discussion entitled "Fundamentals of a Co-op Philosophy" <sup>/5</sup> recently stated:

"Many people in the cooperative movement still look upon a cooperative primarily as a device for harnessing economic power along monopolistic lines which in turn is applied by one group at the expense of another. The result of such a narrow philosophy is simply the creation of another pressure group in a society whose very existence is already threatened by selfish group interests. A much more democratic conception of the use of cooperatives is to regard them as pace-setters, designed to improve, by their example and their competition, the performance of those services in which they engage to the end that society as a whole benefits."

Homer L. Brinkley, General Manager of the American Rice Growers Association, has this to say: <sup>/6</sup>

" . . . in our opinion it is now generally recognized that only Government can exercise the broad-scale controls necessary for the stabilization of agriculture as a whole. Cooperative effort is by its very nature totally unsuited to such an endeavor. The wrecks of farmers' associations which in past years tried their hands at price fixing, production control and such related endeavors is ample evidence to all concerned that such a program applied to agriculture as a whole by cooperatives would be a dismal failure."

Thus the pendulum has swung!

Looking ahead there are two factors now operative which over a long period will have a marked effect on cooperative business enterprises. The first is the small return to equity capital in all business enterprises. The second is the policy of the Anti-Trust Division toward any attempts to usurp, allocate or divide markets, fix prices, or exercise any control of prices beyond first transactions.

The decreasing return to equity capital has been well-analyzed by E. G. Nourse in his preliminary publications on "Price-Making in a Democracy." With increased taxation, particularly on incomes, new equity capital will be increasingly difficult to obtain, especially for new enterprises. The producer,

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<sup>/5</sup> - Babcock, H. E. - Fundamentals of a Co-op Philosophy. Cooperative Digest. May, 1942, p. 22.  
<sup>/6</sup> - American Cooperation 1941. p. 53.

therefore, who seeks a new or better service may be forced to establish it on a cooperative basis to obtain it. The importance of the factor of taxation is illustrated by the fact that today a cooperative which operates in accordance with income tax regulations on an exempt basis and has an overage of \$100,000 at the end of the year which it allocates or distributes to patrons pays no income taxes, while a proprietary company with the same earnings pays in excess of \$45,000 in taxes. The general policy of cooperatives is to operate on established competitive margins and then after deducting costs of operations return any excess on a patronage basis with little or no return on members' equity capital. But the proprietary concern distributes income above costs on the basis of equity capital. When a large portion is taken by taxation there is small inducement to put up equity capital unless some other reward such as increased or better service is in the picture. We have already seen the taxation factor determine whether or not a new agricultural business enterprise would go the cooperative route or proprietary. It is my guess that it will become an increasingly important factor.

The second factor -- the Anti-Trust Division's policies -- is likely to influence the sales practices and policies of cooperatives. I hasten to say in discussing the Anti-Trust Division's policies that I have never seen a statement of their policies toward farmers' cooperatives, nor do I know whether or not the Division has definite policies. What I have to say about their policies is what I have gathered from reading the indictments in the Food Trade industries and listening to discussions of the import of their indictments. To be more accurate, I should say "my interpretation of the Division's apparent policies toward farmers' cooperatives."

First, the Anti-Trust Division does not look with favor on any attempts to usurp or restrict markets to the exclusion of competitors. Hence, if a

cooperative had such a degree of control of a given market area that non-members were excluded from it the association would be subject to prosecution.

Second, the Division is opposed to the cooperative's entering into agreements with competitors to allocate markets, fix prices or disseminate cost data among competitors as a basis for pricing.

Third, the Division -- as indicated in the Chicago Milk Case -- does not countenance attempts to exercise any control over prices beyond the first transaction; in other words, attempts to fix dealer margins or resale prices.

True, many of the apparent policies of the Division have not been tested in the courts, but if I have analyzed them correctly and they are sustained by the courts, some cooperatives may be forced to abandon certain sales practices and policies.

Currently cooperative and commercial concerns alike are facing many critical problems. Competition in many areas is exceedingly keen, margins narrow and at times non-existent. In some areas facilities are excessive. This is especially true in the field of dairy marketing. As a result, several cooperatives in this field have had and are having a struggle, and some have ceased operations. Now a new factor arises -- Government purchase of certain products, principally cheese, evaporated milk and edible skim milk powder. The prices for these products are higher than those of other dairy products. Consequently, those plants not equipped to make the preferred products and unable to get the equipment are at a tremendous disadvantage. At the moment, a dairy plant equipped to make edible skim milk powder can obtain, on a butterfat basis, nearly 10 cents per pound more than a plant equipped to make casein.

Other difficulties arising out of War demands are beginning to appear. Shortages of materials, equipment and transportation confront all business enterprises. At the same time, cooperatives are asked to assume new functions

and responsibilities. They have one advantage in meeting emergency situations, however, and that is the experience their members have gained in sharing burdens as well as opportunities. In emergencies more and more things must be done on a cooperative basis -- and those with cooperative experience forge ahead. My belief is that farmers' cooperatives have and will continue to respond in taking the lead in solving many of the War emergency problems affecting agriculture.