



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

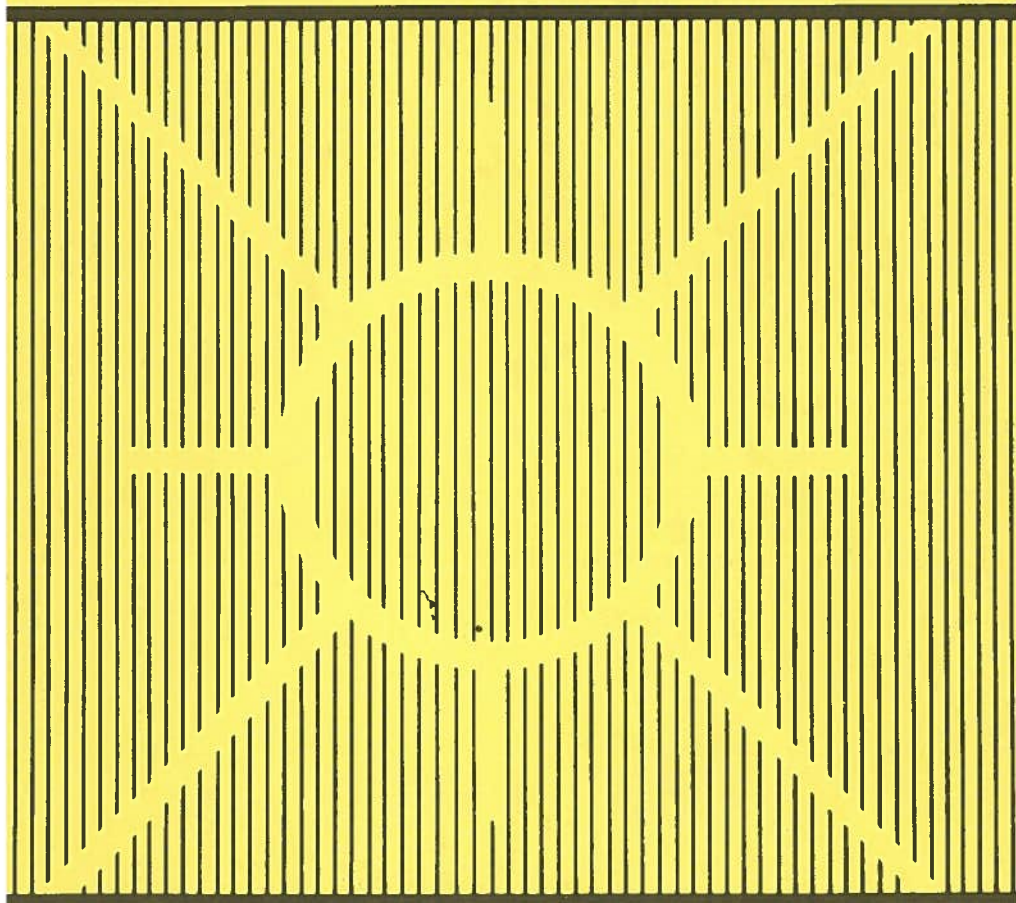
lies of the
nization and
trol of the U.S.
d System

Project 117
ograph 4

EMBER 1978

AGRICULTURAL COOPERATIVES AND THE PUBLIC INTEREST

Proceedings of a North Central Regional Research Committee 117 Sponsored Workshop St. Louis, Mo., June 6-8, 1977



Agricultural Experiment Stations of Alaska, California, Cornell, Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, New Mexico, North Dakota, Ohio, South Dakota and Wisconsin

Published by the Research Division, College of Agricultural and Life Sciences, University of Wisconsin-Madison.

THE SOURCES, LIMITS, AND EXTENT OF COOPERATIVE MARKET POWER: FINANCIAL LAWS AND INSTITUTIONS

Mike L. Cook
Dept. of Agricultural Economics
and Agricultural Business
New Mexico State University

AN INTRODUCTORY PARADIGM

The market performance of agricultural cooperatives and the accompanying constituents of market structure and behavior have been matters of concern in the public policy arena since the passing of the 1865 Michigan law that provided for the incorporation of associations of farmers organized on cooperative principles. One of the areas of recent public concern has been the question of whether or not agricultural cooperatives have gained excessive market power. This paper addresses a frequently bypassed but important element in the study of market power—the province of capital, its role in cooperative growth, and the governmental and institutional environment that affect farmer cooperative acquisition and redemption of equity and debt capital.

Before undertaking this task it is useful to introduce a simple conceptual *modus operandi*. Market power has been defined basically in terms of a structural concept—that is, the ability of a market participant or group of participants to influence price, quantity and the nature of the product in the market place [Brandow, 5; Lanzillotti, 29; Shepherd, 34; Scherer, 33]. Both economic theory and empirical studies support the view that structural characteristics of industries are significant determinants of market conduct and performance. According to Scherer and Shepherd, two of the essential determinants of these structural characteristics are 1) firm and industry growth and 2) the institutional environment influenced (to a large extent) by government policies.

Firm growth almost always involves increasing the firm's stock of human and natural resources. The process through which this growth is fostered is by acquiring the control of additional resources that generate returns in excess of their costs and thereby adding to the value of the firm. In turn, reinvested savings also add to wealth and increase future income generating capacity. Accordingly, the firm is concerned with acquiring capital to finance growth at low cost with due respect to liquidity and risk [Barry, 4]. It can be concluded then that one of the key elements in the dynamics of growth is, at its core, obtaining funds to purchase these resources, either internally or from external sources (Irwin). In this paper these constraints will be restricted solely to governmental/institutional policies.

In theory, a firm seeks the combination of debt and equity as reflected by the financial leverage ratio (debt/equity) that minimizes its average cost of capital (for recent applications of this theory related to farmer cooperatives see Dahl and Dobson, [10, 11]; Fenwick, [14]). After achieving a minimum cost combination of debt and equity, the firm would finance its growth by continuing to sell that com-

bination of debt and equity securities in the financial markets. Such financing has not materialized to a large extent in agricultural cooperatives due to the predominance of relatively small farmer cooperatives that lack access to and have not historically developed markets for equity securities comparable to that of larger corporate firms. As a result farmer cooperatives have relied more heavily on borrowing from the Banks for Cooperatives, retained earnings, and a judiciously nebulous but financially explicit source of equity called deferred or allocated patronage refunds.

In concluding the paradigm we can tentatively agree that to a degree (to date, a yet to be measured degree), cooperative market power (a structural concept) is in part determined by cooperative firm growth. Cooperative firm growth in turn is primarily a function of the process of obtaining external and internal funds which is unequivocally influenced by an environment spawned by governmental and institutional policies. This paper directs attention to these latter two points, firm growth being a function of the capital acquisition process and the resultant governmental and institutional policy modulation. We will first describe the cooperative associations' debt and equity acquisition process, then discuss the government/institutional environment which acts as a boundary in the game of gaining and losing market power and finally speculate as to the future consequences of this regulatory environment on the financial and economic structure of farmer cooperative associations.

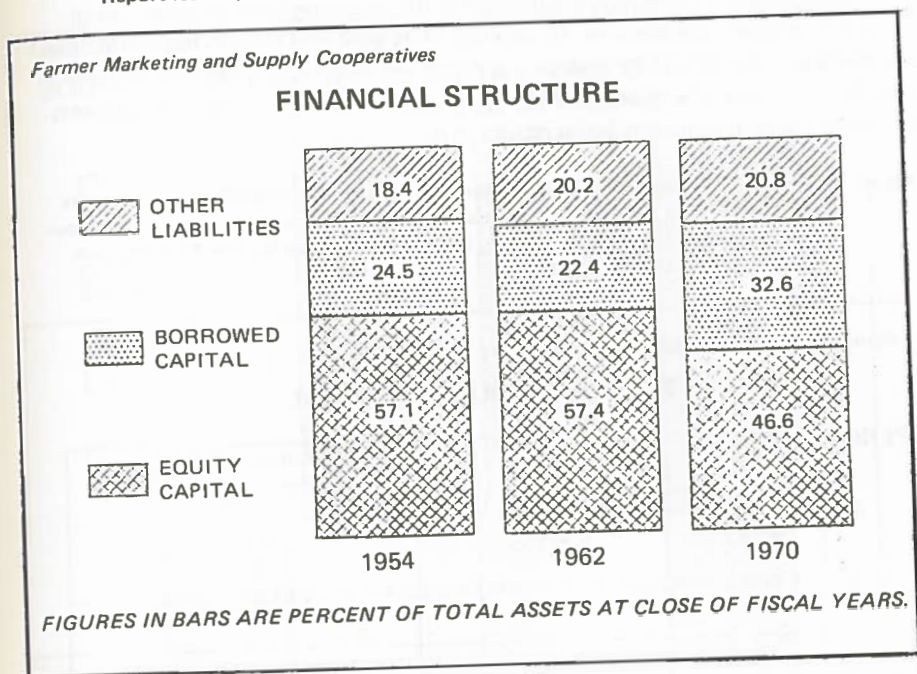
METHODS OF OBTAINING FUNDS FOR FARMER COOPERATIVES

Logical beginning steps in evaluating the financing of farmer cooperatives are to refresh one's mind regarding the nature of the organizations to be dealt with, and to note in somewhat greater detail the main characteristics of the recent and probable future growth trends. Such a review will permit a more comprehensive understanding of the amounts and types of capital needed and of the related financing problems.

Equity capital contributed by the member-patron owner and debt capital are the two major sources of capital utilized by farmer cooperative associations to finance their operations. Traditionally, farmer cooperatives have relied heavily on internally generated capital but figures for fiscal year 1970 (See Figure 1) suggest a trend toward an increasing use of debt capital.¹

Between 1954 and 1962, the financial structure of farmer cooperatives remained relatively static—member-patrons supplied approximately 57 percent of the capital for their cooperatives in both these years. By the close of fiscal year 1970, the member-patrons share of total capital had dropped to less than 47 percent and debt capital had increased to almost one third of total assets. Liabilities other than borrowed capital accounted for approximately 20 percent of total assets for all 3 years—1954, 1962 and 1970. These other liabilities include such items as accounts payable, proceeds payable, and deferred and accrued items (Griffin, 1972).

Figure 1. Farmer Marketing and Supply Cooperatives Financial Structure for the Fiscal Years 1954, 1962 and 1970. Source: Nelda Griffin, *A Financial Profile of Farmer Cooperatives in the United States*, USDA, Farmer Cooperative Service, FCS Research Report No. 23, October, 1972.



Internal Financing (Equity Capital)

Equity capital is classified into two categories, permanent capital and nonpermanent capital. Permanent capital is further subdivided into two categories: (1) common and preferred stock, and (2) unallocated reserves. Common stock is generally used as the voting or membership stock by cooperatives incorporated as stock associations. Membership fees serve the same purpose in nonstock cooperatives. Common and preferred stock represented 37.2 percent of the total equity capital invested in farmer cooperatives in 1970 (See Figure 2).

Unallocated reserves is capital generated by net savings that is not allocated to the member-patron. In 1970, 12.9 percent of total equity capital invested in U.S. farm cooperatives was in the form of unallocated reserves.

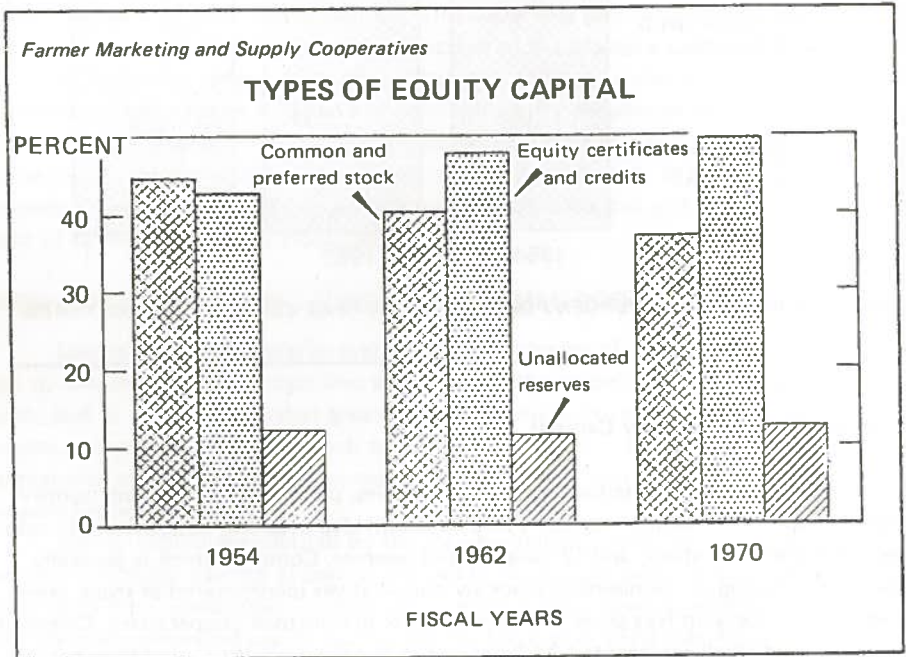
Nonpermanent capital refers to the net savings allocated to member-patrons, but retained in the business. In 1970 this category of investment represented 49.9 percent of the equity capital in all U.S. farmer cooperatives.

The most traditional method of retaining these nonpermanent capital funds has been by the utilization of the revolving fund method of cooperative financing. This method is a plan whereby equity capital provided by the current year's patrons, either through per unit capital retains (in marketing cooperatives), or from savings and margins (in supply cooperatives) earned in operations, is used to retire earlier

member-patron contributions in chronological order. In theory a revolving fund does not become entirely operative until member-patrons have supplied more equity capital than their cooperative needs to remain financially viable.

As a means of obtaining equity capital the revolving fund method is originally and uniquely cooperative. Its application is governed by two basic principles: (1) continual investment by members and patrons in the capital structure from year to year according to use, and (2) continual redemption of these investments with the oldest investments being retired first.

Figure 2. Farmer Marketing and Supply Cooperatives, Types of Equity Capital in the years 1954, 1962, and 1970. Source: Nelda Griffin, *A Financial Profile of Farmer Cooperatives in the United States*, USDA, Farmer Cooperative Service, FCS Research Report No. 23, October, 1972.

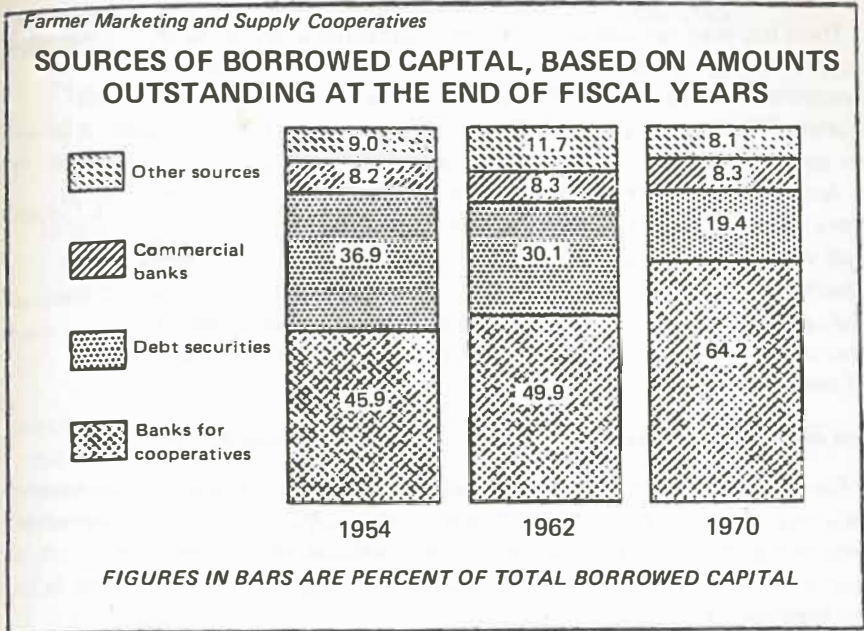


External Financing

Externally generated funds are classified into two categories for this paper, debt or borrowed capital, and capital obtained through merger.

Debt Capital. As suggested by the numbers in Figure 1, there is evidence of a general trend in recent years toward the use of more borrowed funds in the capital structure of farmer cooperatives. As shown in Figure 3, the Banks for Cooperatives are the most important source of this credit for farmer cooperatives and their percentage has been increasing in recent years. The Banks for Cooperatives accounted for almost two-thirds of borrowed capital outstanding at the close of the fiscal year 1970.² Commercial banks accounted for eight percent outstanding at the end of fiscal year 1970.

Figure 3: Farmer Marketing and Supply Cooperatives Sources of Borrowed Capital Based on Amounts Outstanding at the End of Fiscal Years 1954, 1962, and 1970. Source: Nelda Griffin, *A Financial Profile of Farmer Cooperatives in the United States*, USDA, Farmer Cooperative Service, FCS Research Report No. 23, October, 1972.



Debt securities in the form of borrowed capital from members, patrons, and others by direct loans, or through the sale or issuance of certificates of indebtedness, debenture bonds, or other debt instruments accounted for about a fifth of total borrowed capital outstanding at the close of fiscal year 1970.

Other sources accounted for the remaining eight percent of total borrowed capital outstanding at the close of fiscal year 1970. The major type of other debt sources is borrowing from other farmer cooperatives—primarily local member associations borrowing from federated cooperatives.

Mergers. Mueller has suggested that growth among cooperatives can be achieved readily via merger. This compulsion for growth is a recognition of the need to achieve economies of size, to build a stronger financial base, to improve bargaining power, and to enhance cooperative effectiveness in the market place, [Hammond and Cook, 29; Garoian and Cramer, 17]. Because of the multi-objective nature of merging it is difficult to determine the importance of each of the aforementioned variables. Let it suffice to state as did the Far-Mar-Co/ Farmland consolidation committee that a major reason for intercooperative merger is to provide "a stronger financial base for operation."³

THE SOURCES AND LIMITATIONS OF COOPERATIVE MARKET POWER FINANCIAL FACTORS CONSIDERED - *Ceteris Paribus*

In the following two sections specific governmental or institutional policies⁴

that have either facilitated or have deterred, discouraged, or constrained the process of capital acquisition by farmer cooperatives will be discussed.

Sources of Cooperative Market Power - Policies Affecting Equity Acquisition

There has been no explicit government/institutional action taken to enhance or facilitate the equity capital acquisition process of farmer cooperatives although a provision in the Revenue Act of 1962 might have indirectly benefitted some associations. The purpose of the 1962 Act was to allow for the single taxation of farmer cooperative income providing that certain accounting conditions were fulfilled. Any association interested in avoiding tax payment on patronage refunds must pay or allocate the refund within eight and one half months after the end of its fiscal year and must pay at least 20 percent of the refund in cash or by qualified check. The beneficial aspect from the cooperatives point of view is that the associations created goodwill through the cash payment which covers most member-patrons' tax obligation and it induced farmer cooperatives to improve their financial management procedures.

Sources of Cooperative Market Power - Policies Affecting Debt Acquisition

There have been two areas in which governmental/institutional policies have played a major role in facilitating the debt acquisition efforts of farmer cooperatives: (1) through the institutionalization of the Farm Credit Administration and (2) through the quasi anti-trust exemption provided farmer cooperatives in the Capper-Volstead Act.

Farm Credit Administration. Because of the special credit and financial needs of farmer cooperatives and the lack of confidence by commercial banks in newly formed cooperatives, Congress passed the Farm Credit Act of 1933. This Act provided for the organization and capitalization of the 13 Banks for Cooperatives. The Banks for Cooperatives were initially capitalized by the Federal Government and remained largely owned by the Government until the Farm Credit Act of 1953 was passed. This Act, which had the endorsement of farmers and cooperatives, provided for a means of control of the entire Farm Credit System by its member-users and paved the way for the ultimate retirement of all Government capital in the System. Additional legislation enacted in 1955, 1966 and 1968 further emphasized ownership of the System by its member-users which was realized in 1968. The Farm Credit Act of 1971 recodified all the prior laws governing the Farm Credit System, modernized the functions of the System and broadened its lending authorities.

Anti-Trust Exemption. The enactment of the Capper-Volstead Act in 1922 was instrumental in facilitating the combination, coordination among, and merger of farmer cooperatives. Specific provisions of the Act included:

- producers have the right to organize marketing cooperatives with the certainty that they do not violate any anti-trust laws.
- marketing cooperatives can attain a strong economic position as long as it is achieved through voluntary attraction of members and natural growth.
- marketing cooperatives may join with other marketing cooperatives in collectively marketing farmers' products, providing that they comply with provisions of the Capper-Volstead Act [Abrahamsen, 1].

These provisions have created the environment by which farmer cooperatives were allowed to build a stronger financial base through a legally sanctioned framework.

LIMITATIONS OF COOPERATIVE MARKET POWER - POLICIES AFFECTING EQUITY ACQUISITION

This section discusses areas in which governmental/institutional policies related to financing have had or might have a limiting or constraining influence on farmer cooperative growth.

Equity Capital Redemption.

A generally accepted maxim of cooperative financing states that agricultural cooperatives should be financed by member-patrons who are current users of the association. A problem arises when a member-patron no longer using the cooperative's services is expected to continue with his/her financial responsibilities.

This problem has received considerable attention in recent years (Dahl and Dobson, 10, 11; Brown and Volkin, 6; and Cook, 8, 9]. There are resulting economic, psychosocial, cooperative principle, and institutional pressures from member-patron dissatisfaction with the antiquity and slowness of many present day equity capital acquisition and redemption programs. Space precludes a detailed discussion of each of the aforementioned pressures and therefore only institutional pressure is to be treated in this paper.

The governmental/institutional sources of pressure to redeem farmer cooperative equity are observed at two levels, the national level and the state level. These two levels are further subdivided into the following categories: (1) statutes, (2) attempts at changing the statutes, and (3) legal suits.

Federal Statutes. During the past one hundred years, tax provisions and financial stipulations have been legislated into sixteen federal statutes. The legislative wording in the first fourteen of these statutes was basically favorable to the financial operation of farmer cooperatives, but in the fifteenth, the Revenue Act of 1951, the mood of Congress, influenced by extensive Congressional Hearings in 1947, 1950 and 1951, appeared to change.

In the Revenue Act of 1951, Congress adopted provisions intended to insure that all net margins or earnings resulting from the business operations of farmer cooperatives would be subjected to single income tax, either at the cooperative level or patron level. Congress, relying on Department of Treasury rulings which had been in effect for many years thought this single tax objective would be accomplished and therefore made no specific provision as such. The courts, however, misread the intent of Congress and in the Carpenter and Long Poultry Farms cases undermined the single tax objective favored by Congress.

It wasn't until eleven years later that the confusion and uncertainty concerning cooperative tax liability was decided with the enactment of the 1962 Revenue Act. The important provisions implemented in the Act, with respect to equity redemption methods were:⁵ (1) formalization of the single tax principle, (2) tax

deduction status is stipulated, that is, "in order to maintain tax deduction status for allocated patronage refunds, the cooperative must pay at least 20 percent of the allocations in cash," and (3) patron tax liability is made explicit, that is, "if the patron accepts the 20 percent of his patronage refund in cash he must declare all of the refund, both cash and noncash, as income for income tax purposes in the year issued."

These provisions in the Revenue Act of 1962 were the first "major" institutional constraints directed toward the method of equity redemption in farmer cooperatives.

Attempts at Changing Federal Statutes. In addition to attempts in the years of the aforementioned Congressional Hearings (1947, 1950 and 1951) and minor tax amendments in 1966 and 1969, the most nearly successful legislative attempt at enacting mandatory equity redemption procedures for farmer cooperatives, subsequent to the Tax Reform Act of 1962, came in 1969. Bill H.R. 13270 was passed by the House of Representatives and included provisions to: (1) increase to 50 percent the proportion of patronage refunds to be paid in cash in order to qualify the total patronage refunds for deduction by cooperatives, and (2) allow the maximum length of the revolving fund to extend 15 years.

After hearing opposing positions, the Senate Finance Committee decided that these tax provisions were not in the cooperatives' nor the public's best interest and therefore deleted the provisions in H.R. 13270.

The most recent Congressional legislative undertaking that would have had an impact on equity retirement practices was Bill H.R. 4912 introduced in February 1973 by Congressman Hugh Carey of New York. The intent of this bill was to repeal Section 521 and Subchapter T of the Internal Revenue Code and subject the earnings of the farmer cooperative firm to a double income tax — one at the cooperative level and one at the patron level. No Congressional action was taken on H.R. 4912 and as of July, 1977, no new legislation that would have an impact on equity retirement methods had been introduced in either House of Congress.

Federal Judicial Decisions. During the past forty years there have been a number of legal cases decided in federal courts that have dealt with the issue of a member-patron's right to the patronage refunds or payments of a cooperative association.

The two aforementioned cases cited in the section on Federal Statutes, *Commissioner v B.A. Carpenter*, 219 F2d 635 (5th Cir. 1955) and *Long Poultry Farms Inc. v Commissioner*, 249 F2d 746 (4th Cir. 1957) are the only federal decisions, pro tempore at least, which have had significant influence on equity redemption practices in the U.S. In the *Carpenter* case the court held that patronage refunds were reportable by a cash-basis taxpayer member when made or allocated by the cooperative but only at their "fair market value" if in a noncash form. In the *Long Poultry Farms* case the court held that a patronage refund allocated to the account of a member who kept his books and recorded his income on an accrual basis was not a properly accruable item of income to the member in the year in which the allocation was made.

As a result of these two cases, patronage refunds were excluded by the

cooperative at face amount and farmers reported them at their fair market value (usually zero). In effect the decisions permitted a tax deferral in most cases until a patron received his refund in cash. These decisions also exposed the inadequate wording of the 1951 Revenue Act with respect to the Congressional intent of placing a single tax on farmer cooperatives' allocated patronage refunds or payments.

Therefore, at least indirectly, the Carpenter and Long Poultry Farms cases were responsible for the cooperative tax provisions enacted into the aforementioned 1962 Revenue Act. Since the passing of the 1962 Revenue Act, no salient litigation at the Federal level has been concluded with respect to equity redemption practices—the important cases have been adjudicated at the State level.

State Statute Pressure. In a 1977 study⁶ by Cook of a comparison of the state statute provisions describing member-patron equity redemption procedures, the codes of the fifty state statutes were identified as having 73 chapters under which a farmer cooperative could be incorporated. Within these 73 chapters, 26 have provisions whose wording, if interpreted in a certain manner, could exert "a constraint or compelling force of influence" on member-patron equity redemption practices. That is, they are institutional pressures. Of these 26 state chapters, those in Iowa, Nebraska, New Mexico, Rhode Island, and South Carolina have mandatory wording and another sixteen have wording that could be interpreted as having near binding force.

Attempts at Changing State Statutes. In the 1971 Wisconsin Legislative Session, Bill A.B. 1174 was introduced which would have imposed mandatory equity redemption practices on all cooperatives in the state. In the 1973 Wisconsin session, similar legislation was drafted.

In reaction to these attempts a study was made to determine if these were solitary attempts and if not, the magnitude of their appearance. Of the forty state cooperative organizations' "active coordinators," all expressed some degree of concern about the member-patron equity redemption problem. In eight of the states, Minnesota, Mississippi, Nebraska, Ohio, South Dakota, Washington, Wisconsin and Iowa, the method of "pressure" had changed from the more micro state of "member-patron anxiety" demonstrated by expressions of complaints, withdrawals and threatened litigation, to the more macro form which is rendered manifest by evidence of member-patron testimony at legislative hearings and ostensible and formalized encouragement of state statute reform [Cook, 8,9].

State Judicial Proceedings. In the same study, sixty-one State Supreme Court cases were found dealing with member-patron rights in patronage refunds. Seldom were the cooperatives found culpable, but their mere presence in the courtroom exposed several areas in need of amelioration: (1) the need to improve member-patron education, (2) the need to mend their public image, (3) the need to reinvigorate member relations, and (4) the need to be vigilant of the court's opinions (ex. Evandenko and Claasen opinions suggested cause for future litigation). [See Cook, 8, 9, 1976, for detail.]

What about the dynamics of these institutional type constraints? To determine the institutional pressure for mandatory equity redemption in farmer cooperatives, the state and national levels are combined into three categories of

institutional pressure: statutes, attempts at changing statutes, and judicial decisions.

Statutes. The most recent enactment of legislation, at either the state or national level, exhibiting a constraining force on member-patron equity redemption procedures has been the 1962 Federal Revenue Act. Since 1962 the numerous attempts made at changing statute provisions have been unsuccessful.

Attempts At Changing Statutes. Unsuccessful attempts at changing statutory provisions related to member-patron equity redemption procedures have been defined as a form of "pressure" on the financial operating practices of farmer cooperatives. As can be observed from the figures in Table I, the rate at which this pressure is being applied has been increasing since the end of World War II, most recently in the state of Iowa.

Table I. The Number of Reported Attempts Since W.W. II to Change Federal and State Statute Provisions Related to Farmer Cooperative Member-Patron Equity Redemption Practices, January, 1977.

Period	Number of Reported Attempts
1946 - 1950	1
1951 - 1955	1
1956 - 1960	0
1961 - 1965	2
1966 - 1970	3
1971 - 1976	9

Source: Mail and telephone survey.

Four of these attempts were at the Federal level, eleven at the State level.

Judicial Rulings. The figures in Table II indicate that there has been an increase in the number of cases related to member-patron equity redemption procedures in farmer cooperatives since World War II.

Table II. The Number of Judicial Rulings or Cases in Litigation Related to Farmer Cooperative Member-Patron Equity Redemption Practices Since W.W. II, January, 1977.

Period	Number of Cases
1946 - 1950	3
1951 - 1955	3
1956 - 1960	3
1961 - 1965	5
1966 - 1970	5
1971 - 1976	12*

* Presently there are 2 cases in litigation in the states of Texas and Colorado

Source: State and Federal reports.

It is of special significance to note that two of the cases during the 1960's and eleven of the cases since 1970 have dealt with the question of time of distribution of patronage refunds to member-patrons, the most sensitive issue in the mandatory equity redemption problem.

Federal and State Security Laws. Cooperatives are in competition in most lines of business with large commercial enterprises that have broad financial bases. One main source of strength of the business corporation is its direct access to the capital markets. In this respect, cooperatives are at a serious disadvantage with their business corporation competitors because of their inability to interest the financial community or the investing public in their securities. This disability derives directly from the fact that cooperatives do not issue equity securities that can appreciate in value and permit owners to profit in proportion to their investment. It is further aggravated by other characteristics such as restrictions on dividends and transferability of securities, which limit a cooperative's ability to obtain true public financing.

Farmer cooperatives have generally considered themselves exempt from registration under the Securities Act of 1933—and under the "blue sky" laws of the states in which they operate—primarily because the relationship between a farmer and his cooperative is so unique that the investment paper issued has not generally been regarded as a "security" within the meaning of the federal security laws.

Recent developments have raised some doubt as to whether all paper issued by agricultural cooperatives is in fact entirely exempt from the 1933 act or the "blue sky" laws, which vary somewhat from state to state. The security laws are not explicit, and in the minds of many are questions regarding intent. Also, the variety of functions and practices of a very limited number of today's cooperatives contributes to the growing concern about the presence of a "security."

In 1975, the Bureau of Enforcement staff of a regional office of the Securities and Exchange Commission (SEC) took the position that per-unit retains and allocated patronage refunds, as well as membership and marketing agreements, were securities and were therefore subject to the registration provisions of the federal security laws. The Commission, however, has not issued a ruling in the case or issued a public release on what constitutes a security.

Many cooperative lawyers and accountants take the position that the existing federal security laws were not designed to cover the unique patronage relationship that exists in farmer cooperatives. An attempt has been underway over a period of years to clarify the security laws by Professor Louis Loss of the Harvard Law School, who, supported by the American Law Institute, has almost completed the final drafting of a new Federal Security Code. As presently drafted, the proposed code would involve some changes and clarifications of existing exemptions for cooperatives. A final draft of the new code is expected to reach Congress for consideration and probable eventual enactment into law within the next 2 years. Until this takes place, or until SEC comes out with a public release on what constitutes a "security," cooperatives will need to individually examine their own financial structure and financing practices, and their relationship with those who provide them with capital, to determine their legal status under current laws and regulations [Griffin, 19].

Taxes. The impact of the proposed and existent regulations regarding double taxation and capital gains taxes on the process of equity capital acquisition is discussed in the Raup and Schrader papers.

LIMITATIONS OF COOPERATIVE MARKET POWER - POLICIES AFFECTING DEBT ACQUISITION

Banks for Cooperatives Lending Limits. Farmer cooperatives borrowing from the Banks for Cooperatives are subject to specific Farm Credit System developed borrowing limits. An individual district Bank for Cooperatives, of which there are twelve, possesses the following loan capacity; it is allowed to loan to a regional or local farmer cooperative 50 percent of its net worth over three types of loans: 25 percent of its net worth in the form of a term loan, 10 percent as a commodity loan, and 15 percent as a seasonal loan. If the amount borrowed from the district Bank for Cooperatives does not satisfy the financing needs of the farmer cooperative the district bank normally invites the Central Bank for Cooperatives to participate in loaning up to 50 percent of the Central Bank's net worth. If the individual farmer cooperative is still in need of credit the Banks for Cooperatives have access to a "participating agreement" whereby the district banks pooling their funds can loan money based on a net worth formula (a maximum of \$215 million to any one farmer cooperative in 1977). When the Banks for Cooperatives System has reached its lending limit the system provides commercial bank linkage services. This forces the individual farmer cooperative to seek funds with sources external to the Farm Credit System where interest rates are higher than those charged by the Banks for Cooperatives.

Mergers. From the passing of the Capper-Volstead Act to recent calls for investigation of the Far-Mar-Co/Farmland merger, joint action or coordination among farmer cooperatives has been a center of query by legal and regulatory agencies [Knutson 28, 1969, Helmberger 22, 1966]. Questions like what constitutes a producer and to what extent can a farmer cooperative control or increase its share of the market and still not be held in violation of Section 2 of the Sherman Act have yet to be answered. This genus of environmental uncertainty is not conducive to sound or stable financial planning which is an important element of firm growth management.

CONCLUSIONS

It has been posited that farmer cooperative market power, is in part at least, a function of the process of debt and equity capital acquisition. Paul implied a somewhat similar hypothesis when he suggested that the "idea of capital is at the very foundation of market structure . . . Markets become restructured only as new decisions are made on how capital is to be used." [Paul, 32; p. 42].

At the same time one of the key elements in this restructuring is governmental/institutional influence through policies such as antitrust legislation and enforcement and tax regulation and through policies which indirectly influence determinants of market structure such as firm growth. In this paper several governmental/

institutional policies that have affected the farmer cooperative method of capital acquisition, the recognized nucleus of the firm growth process. It can be concluded that a number of these governmental/institutional policies have and will continue to have a significant influence upon this important structural determinant. structural determinant.

It has been demonstrated that the institutionalization of the Farm Credit Administration has had a far reaching impact upon market structure at the farm input, farm production, and food handling and processing levels. It is assumed that this impact has been positive in that economic competitiveness at these levels has been enhanced.

But it is with respect to equity capital acquisition and redemption that governmental/institutional influence through sundry policies might have its most consequential impact upon farmer cooperative growth. Friction under the guise of economic, cooperative principle, psychomemblic, and institutional pressure is threatening to institute a mandatory equity redemption program within the farmer cooperative organization practices. This phenomenon endangers the traditional revolving fund method of farmer cooperative financing—an operating practice that agrees with the basic principles of cooperation. This raises the question—can farmer cooperatives protect their unique character as cooperative organizations. If the equity acquisition and the accompanying equity redemption problems are not solved, the expected future growth of farmer cooperatives, as they are presently organized, might never be realized.

What are the alternatives? Do farmer cooperatives need governmental/institutional assistance with equity capital assistance as they once did with debt capital acquisition? Are there means by which to generate equity capital and still maintain the unique cooperative character that appears to be so dearly coveted by much of the rural populace?

Let's briefly speculate as to the options the two actors, individual producers through their local and regional cooperatives, and the governmental/institution policymakers, might have.

The cooperative firm has two alternatives for financing growth, 1) It can arrange cooperative finance to meet the requirements of corporation finance which includes the concept of permanent capital, 2) or it can enhance or improve the present method of financing to fit the cooperative form of business organization.

It is important to remember when looking at the problem as a whole: "it can be said that to the extent cooperatives conduct their affairs in the same manner as other business corporations, they are more likely to be regulated as regular business corporations. On the other hand, to the extent cooperatives confine their financing activities to patrons and members, they are more likely to be viewed as entitled to special treatment that recognizes their legitimate concerns and differences" [Weiss, 40; p. 9].

The government/institutional policymaker has three alternatives: 1) to allow the unanswered questions which continue to augment uncertainty and indecision, 2) to manipulate the firm growth variable (in operational form it might be the process of farmer cooperative capital acquisition) so as to limit or discourage cooperative firm growth, or 3) to manipulate the firm growth variable so as to encourage cooperative growth.

If we assume that the government/institutional policymaker's charge is to improve the market performance of the food and fiber system, it might be in our best interests that he/she/it consider capital acquisition and redemption patterns within the system as the best control method for improving that performance. There is one major defect in this recommendation (which might be considered a challenge to someone)—that is, we have not significantly improved our understanding of the relationship between "capital" and the concept of market performance since that day in 1964 when Allen B. Paul wrote, "If one could harness market enlargement with the ideas about capital and finance that are available, we would take a major stride toward realism in identifying and analyzing marketing problems" (Paul, 32; p. 41).

REFERENCES

1. Abrahamsen, Martin A., *Cooperative Business Enterprise*, McGraw-Hill Book Company, 1976, p. 196.
2. Baarda, James R., "Legal Issues - Meeting the Challenge," *Farmer Cooperatives*, Vol. 43, No. 2, May, 1976, pp. 4-6.
3. Baker, C. B., "Introduction to Economic Growth of the Agricultural Firm," *Economic Growth of the Agricultural Firm*, College of Agriculture Research Center, Washington State University, Technical Bulletin 86, February, 1977.
4. Barry, Peter J., "Theory and Method in Firm Growth Research," *Economic Growth of the Agricultural Firm*, College of Agriculture Research Center, Washington State University, Technical Bulletin 86, February, 1977.
5. Brandow, G.E., "Market Power and Its Sources in the Food Industry," *American Journal of Agricultural Economics*, Vol. 51, No. 1, February, 1969, pp. 1-12.
6. Brown, Phillip F. and David Volkin, *Equity Redemption Practices of Agricultural Cooperatives*, U.S. Department of Agriculture, Farmer Cooperative Service, FCS Research Report 41, April, 1977.
7. *Business Week*, "The Billion-Dollar Farm Co-ops Nobody Knows," February 7, 1977, pp 54-64.
8. Cook, Michael Lee, "An Economic and Legal Analysis of Farmer Cooperative Equity Capital Redemption Policies," unpublished Ph.D. thesis, University of Wisconsin, Madison, 1976.
9. Cook, Michael Lee, "Increased Institutional Pressure for Mandatory Equity Retirement in Farmer Cooperatives," *The Cooperative Accountant*, Vol. XXIX, No. 3, Fall, 1976.
10. Dahl, Wilmer A. and W. D. Dobson, "An Analysis of Alternative Financing Strategies and Equity Retirement Plans for Farm Supply Cooperatives," *American Journal of Agricultural Economics*, Vol. 58, No. 2, May, 1976, pp. 198-201.
11. Dahl, Wilmer A. and W. D. Dobson, *Reducing Financing Costs and Financial Management Problems of Cooperatives*, Research Division, College of Agricultural and Life Sciences, University of Wisconsin, Madison, June, 1976.
12. Devino, Gary T., Stephen E. Mathis and Francis P. McCamley, "Identification of Growth Potential for Locally Owned Farmer Cooperatives," Contributed

- Paper, presented at American Agricultural Economics Association Annual Meeting, State College, Pennsylvania, August, 1976.
13. Farris, Paul L., ed., *Market Structure Research, Theory and Practice in Agricultural Economics*, Ames, Iowa, Iowa State University Press, 1964.
 14. Fenwick, Richard S., Jr., "Capital Acquisition Strategy for Missouri Farm Supply Cooperatives," unpublished Ph.D. dissertation, Department of Agricultural Economics, University of Missouri, Columbia, 1972.
 15. "Financial Management, Seminar Proceedings," Conducted by U.S. Department of Agriculture, Extension Service, June 15-16, 1972.
 16. Garoian, Leon and Gail L. Cramer, "Merger Component of Growth of Agricultural Cooperatives," *American Journal of Agricultural Economics*, Vol. 50, No. 5, December, 1968, pp. 1472-1483.
 17. Garoian, Leon and Gail L. Cramer, *Cooperative Mergers: Their Objectives, Success, and Impact on Growth*, Oregon Agricultural Experiment Station, Bulletin 605, February, 1969.
 18. Garoian, Leon and Paul O. Mohn, "The Board of Directors of Cooperatives," Division of Agricultural Sciences, University of California, July, 1976.
 19. Griffin, Nelda, "Securities Situation Concerning Farmer Cooperatives," *Farmer Cooperatives*, Vol. 43, No. 1, April, 1976, pp. 4-8.
 20. Griffin, Nelda, *A Financial Profile of Farmer Cooperatives in the United States*, FCS Research Report No. 23, Farmer Cooperative Service, USDA, October, 1972, p. 18.
 21. Hammond, Jerome W. and Hugh L. Cook, *Wisconsin Dairy Firm Mergers: Extent, Causes and Results*, Wisconsin Agricultural Experiment Station, Research Bulletin 249, 1964.
 22. Helmlinger, Peter G., "Future Roles for Agricultural Cooperatives," *Journal of Farm Economics*, Vol. 48, No. 5, December, 1966, pp. 1427-1435.
 23. Hopkin, John A. and J. E. Doyle, "How's Your Liquidity?" *News for Farmer Cooperatives*, Vol. 40, No. 2, May, 1973, pp. 8-9.
 24. Irwin, George D., "A comparative Review of Some Firm Growth Models," *Agricultural Economics Research*, Vol. 20, No. 3, 1968, pp. 82-100.
 25. King, Richard A., "Morphology, Modes of Behavior and Measures of Market Power," *Southern Journal of Agricultural Economics*, December, 1970.
 26. Knutson, Ronald D., "Cooperatives and the Competitive Ideal," *Journal of Farm Economics*, Vol. 48, No. 3, Part II, August, 1966, pp. 111-121.
 27. Knutson, Ronald D., "Cooperative Strategies in Imperfectly Competitive Market Structures - A Policy Perspective," *American Journal of Agricultural Economics*, Vol. 56, No. 5, December, 1974, pp. 904-912.
 28. Knutson, Ronald D., "Nonproducer Cooperative Interests and the Antitrust Laws," *American Journal of Agricultural Economics*, Vol. 51, No. 2, May, 1969, pp. 335-341.
 29. Lanzillotti, Robert F., "The Superior Market Power of Food Processing and Agricultural Supply Firms - Its Relation to the Farm Problem," *Journal of Farm Economics*, Vol. 42, No. 5, December, 1960, pp. 1228-1247.
 30. Mischler, Raymond J. and David Volkin, *How the Revenue Act of 1962 Affects Farmer Cooperatives*, Farmer Cooperative Service, USDA, General Report 105, October, 1962.

31. Parker, Russell C., "Antitrust Issues in the Food Industries," *American Journal of Agricultural Economics*, Vol. 48, No. 5, December, 1976, pp. 854-860.
32. Paul, Allen B., "Capital, Finance, and Market Structure - Two Approaches," *Market Structure Research, Theory and Practice in Agricultural Economics*, Farris, Paul L., ed., Ames, Iowa, Iowa State University Press, 1964.
33. Scherer, F. M., *Industrial Market Structure and Economic Performance*, Rand McNally & Company, 1970.
34. Shepherd, William G., *Market Power and Economic Welfare*, New York, Random House, 1970.
35. *Statistics of Farmer Cooperatives*, U.S. Department of Agriculture, Farmer Cooperative Service, FCS Research Report 39, April, 1977.
36. Tipon, Emmanuel S., "Cooperative Associations: Rights in Equity Credits or Patronage Dividends," *American Law Reports*, ALR 3d, Cases and Annotations, Vol. 50, The Lawyers Cooperative Publishing Company, Rochester, New York, 1973.
37. Torgerson, Randall E., "The Economic Impact of Cooperatives," Talk presented to the Production Credit Conference, June 12, 1969, University of Missouri, Columbia, Ag. Econ. Paper #1969-24.
38. Tubbs, Allan R. and Richard R. West, "Use of Debt in Coöperative Capital Structure," *News for Farmer Cooperatives*, Vol. 39, No. 2, May, 1972, pp. 16-18.
39. Walker, Odell L. and James R. Martin, "Firm Growth Research Opportunities and Techniques," *Journal of Farm Economics*, Vol. 48, No. 5, December, 1966, pp. 1522-1531.
40. Weiss, Jerome P., "So You Think You're Exempt From Federal Securities Laws," *News for Farmer Cooperatives*, Vol. 42, No. 1, April, 1975, pp. 6-9.
41. Williamson, Oliver E., *Markets and Hierarchies: Analysis and Antitrust Implications*, New York, The Free Press, 1975.
42. Youde, James and Peter Helmberger, "Membership Policies and Market Power of Farmer Cooperatives in the United States, Case Studies of 31 Cooperatives," Department of Agricultural Economics, College of Agriculture, University of Wisconsin, Resume for Research Bulletin 266, August, 1966.

NOTES

- 1 The data in the following two sections comes from the Farmer Cooperative Service (FCS) financial profile studies done in 1954, 1962, and 1970. Presently a fourth profile survey is underway but no preliminary data were available when this paper was written.
- 2 For 1976 the Banks for Cooperatives made loans totaling \$9.9 billion, a 15.1% increase over the amounts loaned in 1975.
- 3 *Farmland News*, February 15, 1977, p. 11.
- 4 Institutional policies are defined as state or federal judicial or administrative rulings, edicts or codes. Governmental policies are of legislative or executive origin.
- 5 See Mishler and Volkin, *How the Revenue Act of 1962 Affects Farmer Cooperatives*, General Report 105, Farmer Cooperative Service, USDA, October, 1962.
- 6 Forthcoming paper.