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BY THE COMPTROLLER GENERAL

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Report To The Congress

OF THE UNITED STATES

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Family Farmers Need Cooperatives--But Some Issues Need To Be Resolved

The Nation's family farmers need the right to act together through cooperatives if many are to survive in agriculture. However, the Department of Agriculture needs to establish an enforcement and monitoring system to ensure that cooperatives do not use monopolistic or other unfair trade practices to raise prices unduly, as critics have charged.

The Congress needs to decide whether it is in the Nation's best interest to allow nonfamily farm corporations to continue to be cooperative members.

Many cooperatives need to adopt equity redemption programs that are fair to both current and former members.

GAO found cooperative officials generally satisfied with the quality and quantity of technical and educational assistance available from the Department of Agriculture.

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UNITED STATES GENERAL ACCOUNTING OFFICE

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the importance of cooperatives to family farmers in the current agricultural structure and actions needed to be taken by the Congress and the Secretary of Agriculture to help ensure that cooperatives remain a viable force in assisting family farmers.

Because most of the basic legislation affecting cooperatives was enacted many years ago, we made this review to determine if changes were needed in light of today's agricultural economy and if conditions prevent or hinder the congressional intent to advance the economic well-being of the Nation's family farmers.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Agriculture; interested congressional committees and subcommittees; and Members of Congress.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FAMILY FARMERS NEED COOPERATIVES--BUT SOME ISSUES NEED TO BE RESOLVED

D I G E S T

Are agricultural cooperatives needed? Knowledgeable people say yes--family farmers need the right to act together through cooperatives if many are to survive. Farmers still face some of the same problems they faced in the 1920s and 1930s when legislation first allowed them to form cooperatives to compete more effectively in the agricultural system. But some issues need to be resolved and some changes made.

Rec. The Congress should determine whether it is in the Nation's best interest to continue to allow nonfamily farm corporations to be members of cooperatives. (See pp. 36 and 37.)

The Secretary of Agriculture should

--Establish an enforcement and monitoring system so that cooperatives do not use monopolistic or other unfair trade practices to raise prices unduly. (See p. 23.)

--Develop a set of cooperative conduct principles with the Federal Trade Commission and the Department of Justice. (See p. 23.)

--Require that a national campaign be conducted to motivate cooperatives to adopt equity redemption programs that are fair to current and former members. If cooperatives are not willing to do so voluntarily, legislation for mandatory programs should be proposed. (See p. 44.)

--Require that plans for assisting new and developing cooperatives be coordinated among responsible agencies before additional field offices are established. (See p. 55.)

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TRENDS IN AGRICULTURE

The overall trend in American agriculture has been one of increasing concentration marked by (1) a decrease in the number of farms and an increase in average farm size, (2) a greater share of total gross farm income going to large farms, and (3) a larger portion of agricultural products handled by a smaller number of suppliers. The trend in the number, size, and market share of cooperatives has been similar to the overall trend.

Although cooperatives have grown in size and market share, they are still much smaller than some other businesses that compete with them in such markets as grains, fruits and vegetables, dairy products, poultry and eggs, and feed. (See pp. 4 to 12.)

ROLE AND IMPORTANCE OF COOPERATIVES

Cooperatives are an integral part of the agricultural structure. They provide farmers an alternative for marketing products and for procuring farm items and services and opportunities to (1) store raw and finished products to increase market stability, (2) bargain collectively over prices, and (3) retail their products and share in the profits from those markets.

The Secretary of Agriculture, GAO's consultants, and Federal Trade Commission and Department of Justice officials all say that cooperatives are needed today and in the future if family farmers are to survive in the highly organized agricultural economy. Most farmers responding to a ~~GAO~~ questionnaire viewed cooperatives as increasing the income and promoting a better way of life for family farmers. (See pp. 12 to 14.)

POSSIBLE ABUSE OF MARKET POWER

As cooperatives have grown in size and market share, they have come under increasing attack by some critics who charge that cooperatives have garnered a dominant market position in some commodities and increased prices, thereby fueling inflation. (See p. 15.)

The law charges Agriculture with making sure that cooperatives do not use their advantages to "unduly enhance" prices. There has never been a documented case of a cooperative doing so. For that matter, the term "undue price enhancement" has never been universally defined.

AGC00059

Even so, the Federal Trade Commission staff, Justice, and others have expressed concern that some cooperatives are in a position to gain undesirable market power over prices and are becoming a threat to competition in some sectors of the agricultural economy. GAO's consultants view some cooperative practices, such as exclusive supply requirements to control the total production of members and closed membership policies not justified by economic or marketing conditions, as having the potential of resulting in unfair trade or marketing practices. (See pp. 15 and 20.) AGC00037

Agriculture has done very little to guard against undue price enhancement and other unfair practices. Some have questioned whether it can effectively regulate cooperatives and at the same time promote their growth and development. The President's National Commission for the Review of Antitrust Laws and Procedures has recommended separation of these functions either within or outside Agriculture. GAO agrees. (See pp. 18 to 20.)

If Agriculture retains the regulatory function, it needs to establish a system to monitor cooperative activities and to take enforcement action where warranted. An Agriculture study to improve its oversight responsibilities was completed in June 1979. (See p. 23.)

Cooperative officials are confused as to what activities could be subject to legal action by the Government. Some cooperatives may have passed up opportunities to serve family farmers better because of the perceived threat of legal action.

To help clear the air, Agriculture should develop jointly with the Federal Trade Commission and Justice a set of cooperative conduct principles. Suggested conduct principles are included on pages 21 and 22.

SHOULD NONFAMILY FARM CORPORATIONS BE PERMITTED TO JOIN COOPERATIVES?

An emerging issue is corporate membership in cooperatives. As far as GAO could determine, the Congress has not taken a position on this issue. (See p. 29.)

Nonfamily farm corporations have joined cooperatives and enjoyed benefits the Congress intended mainly for family farmers. GAO's consultants view this as encouraging such corporations to expand their farming interests, further threatening the position of the family farmer. However, corporations contribute to cooperatives by providing management expertise and product volume, which can lead to operating efficiencies. (See p. 34.)

The number of nonfamily farm corporations in cooperatives is small at this time. However, their membership in some cooperatives has probably kept out some family farmers. GAO noted two instances where cooperatives with nonfamily farm corporate members were not accepting all applicants for membership because the cooperatives had all the business they could or wanted to handle.

Although the corporate share of these cooperatives' business was relatively small (under 5 percent), the fact remains that without that volume, the cooperatives would have had room for other family farmers. (See p. 35.)

Farmers responding to a GAO questionnaire had mixed reactions on this issue. About 56 percent felt that nonfamily farm corporations should be allowed to join cooperatives, while 30 percent felt they should not. The other 14 percent felt that some limitations on gross sales (usually less than $500,000) should apply to such corporate members. (See p. 34.)

EQUITY RETIREMENT PRACTICES

An issue of major concern to farmers is the failure of many cooperatives to retire systematically the retained earnings owed their members. (See p. 39.)

A key feature of cooperatives is to operate at cost and distribute earnings to member-patrons annually. To avoid Federal income taxes, cooperatives must distribute at least 20 percent of their earnings to members in cash. Up to 80 percent of the distributed earnings can be in the form of equity certificates. Farmer members are liable for taxes on the entire distribution even though they receive as little as 20 percent in cash.

Many cooperatives have no plans for or are slow in paying off equity certificates, even if members have died or retired. Of the 83 cooperatives GAO visited, 56 did not have a systematic equity redemption program; they were holding equities totaling over $750 million. Many were holding equities earned more than 15 years ago; some, over 30 years ago. (See p. 41.)

The failure to retire retained equities in a timely manner can affect farmers' participation in cooperatives. Over 65 percent of the farmers ~~GAO~~ queried said that they would be encouraged to start or to increase their business with cooperatives if cooperatives did not wait so long to retire retained equities. About 75 percent said that they would do so if the cooperatives paid dividends or interest on retained equity. (See p. 42.)

An Agriculture report, which cited several reasons cooperatives gave for not systematically retiring their retained equities, said these reasons had little merit. (See p. 40.)

Agriculture favors an education program to encourage cooperatives to retire retained equities. (See pp. 42 and 43.)

FEDERAL ASSISTANCE TO COOPERATIVES

Agriculture has provided technical and educational assistance to farmers in organizing and operating cooperatives since the early days of the movement. Cooperative officials in the eight States included in GAO's review said that they were satisfied with the quality of services available and perceived no great need for expanding them. (See p. 51.)

Agriculture's Cooperatives Unit perceives an increasing need to help farmers, particularly low-resource and minority farmers, to organize and develop cooperatives. However, its plans to establish five field offices by fiscal year 1980 to assist in carrying out this work had not been coordinated with Agriculture's Extension component to avoid possible duplication of effort. (See pp. 52 to 54.)

AGENCY COMMENTS

Agriculture said that it was proceeding to establish formally an enforcement and monitoring system so that cooperatives do not raise prices unduly, and it agreed to fully coordinate plans before establishing additional field offices. It also agreed to conduct a national campaign to motivate cooperatives to adopt more equitable equity redemption programs, but disagreed that it should propose legislation requiring cooperatives to adopt such programs if they do not do so voluntarily. (See pp. 23, 45, and 55.)

Agriculture agreed that the Congress needs to determine whether nonfamily farm corporations should be allowed to be cooperative members. Justice expressed concern that large agribusiness corporations involved in cooperatives could affect the viability of the family farm and the vigor of competition. Both said, however, that more information was needed before the Congress could decide on the action to be taken. (See p. 37.)

The Federal Trade Commission staff generally agreed but Agriculture and Justice generally disagreed with GAO's recommendation on developing cooperative conduct principles. GAO continues to believe such principles are needed. Its evaluation of Agriculture and Justice comments is on pages 24, 25, and 28.

Contents

ABBREVIATIONS

GAO General Accounting Office

VPI Virginia Polytechnic Institute and State University

CHAPTER 1

INTRODUCTION

Agricultural cooperatives and the laws under which they are administered have been the subject of much controversy in recent years.

Since the beginning of commercial agriculture in the United States, family farmers, acting independently, have typically been too small and too numerous to deal effectively with the much larger firms operating in the supply, processing, and marketing sectors of the agricultural economy. During the late 19th and early 20th centuries, family farmers tried to overcome this imbalance of market power by organizing cooperative associations to jointly market their products and buy farm-related supplies and services. Some State courts declared marketing cooperatives to be illegal under their antitrust laws. As a result, the Congress passed several acts to help farmers become more competitive.

LEGISLATIVE HISTORY OF AGRICULTURAL COOPERATIVES

The first important piece of legislation was section 6 of the Clayton Act of 1914 (15 U.S.C. 17). This section exempted agricultural organizations from antitrust laws if they were established for mutual help, did not have capital stock, and were not conducted for profit. Shortly thereafter, the Congress enacted the Capper-Volstead Act of 1922 (7 U.S.C. 291) authorizing producers of agricultural products to act together in associations, with or without capital stock, to (1) collectively process, prepare for market, handle and market their products in interstate and foreign commerce and (2) have marketing agencies in common.

Other acts grant farmers and their cooperatives special privileges and/or services in addition to the right to organize. Some of the more important ones are:

--The Cooperative Marketing Act of 1926 (7 U.S.C. 451, 455), which authorizes farmers and their cooperatives to acquire, exchange, interpret, and disseminate past, present, and prospective crop, market, statistical, economic, and other similar information by direct exchange and/or by and through common agents.

--The Farm Credit Act, as amended (12 U.S.C. 2001, 2128 *et seq.*), which established cooperative banks to provide financial and technical assistance to cooperatives.

--The Agricultural Adjustment Act (1933) as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601, 608c), which provides for establishing marketing orders for specific fruits, vegetables, nuts, and milk. It (1) authorizes cooperatives to vote in behalf of their members on marketing orders and (2) allows dairy cooperatives to continue to combine and distribute net proceeds of all sales of milk and milk products to producers in accordance with contracts between them and their producers and to provide certain marketing services otherwise performed by a market administrator for a fee. It also directs that marketing orders be administered to accord recognition and encouragement to cooperatives.

The Internal Revenue Code provides for taxing a cooperative's earnings only once--either as income to the cooperative or to its member-patrons. A qualified or exempted cooperative is permitted to deduct from income (1) dividends paid on its capital stock and earnings, (2) income derived from business done with the United States or any of its agencies, and (3) certain other nonpatronage income, such as rents received and gains on sale of capital assets.

Because most of the basic legislation affecting cooperatives was enacted many years ago, we made this review to determine if changes were needed in light of today's agricultural economy. We were also concerned with those conditions involving cooperatives that prevent or at least hinder the congressional intent to advance the economic well-being of the Nation's family farmers. To assist us in our review, we employed two consultants--Dr. Ronald D. Knutson and Dr. Leon Garoyan. (See app. I for biographical statements.)

SCOPE OF REVIEW

To gain insight into major cooperative issues, problems, and needs, we interviewed (1) key officials within the Departments of Agriculture and Justice, the Federal Trade Commission, and the National Council of Farmer Cooperatives and (2) selected university, cooperative, and other knowledgeable officials in the States of Alabama, California, Kansas, Minnesota, Missouri, North Carolina, Virginia, and Wisconsin. We examined cooperative legislation and related legislative histories, reviewed an extensive number of studies and articles dealing with cooperative matters, and analyzed statistical and other available information.

To add an additional perspective to our review, we sent a specially designed questionnaire to a random sample of farmers in 12 States representing each region of the United States to solicit their views on selected cooperative matters. The total sample size was 672 farmers allocated to each State in proportion to that State's farm population. Agriculture's Statistics Unit selected the sample for us from its general inventory of farmers. We received responses from 487 farmers, or about 72 percent. (See app. II.)

Within the total framework of cooperative law, the changing agricultural structure, and the growth and composition of cooperatives, we focused on the following major issues for our review.

--Does the public need to be better protected against cooperative market power?

Some observers are alarmed by the growth in cooperative size and market share over the years. Others believe that limiting cooperatives' legislated advantages could weaken the competitive position of family farmers. (See ch. 3.)

--Should nonfamily farm corporations be permitted to join cooperatives?

One view is that letting nonfamily farm corporations join cooperatives will encourage the expansion of such corporations into farming at the expense of the family farmer. Another is that cooperatives benefit from having corporation members. (See ch. 4.)

--Is Government action needed to encourage cooperatives to retire long-outstanding retained equities owed to farmer members?

Many farmers view the failure to retire equities in a timely manner as a major disincentive to their participation in cooperatives. Cooperative officials cite various reasons for not retiring equities. (See ch. 5.)

--Are technical and educational assistance needs of cooperatives adequately met?

The Federal Government and others make a variety of technical and educational services available to cooperatives to help them help family farmers. Cooperative officials are generally satisfied with the quality and quantity of assistance available to them. (See ch. 6.)

CHAPTER 2

ROLE OF COOPERATIVES IN THE CURRENT AGRICULTURAL STRUCTURE AND THEIR IMPORTANCE TO FAMILY FARMERS

The view expressed by our consultants, the Secretary of Agriculture and other agricultural experts, other Government officials, and farmers is that independent family farmers need the right to act together through cooperatives if many are to survive in today's highly concentrated agricultural structure.

THE AGRICULTURAL STRUCTURE

American agriculture is made up of many commodity groups integrally woven into the supply, production, processing, servicing, and marketing sectors of the economy. While variances in each commodity group exist, the overall trend has been one of increasing concentration. Indicators of this concentration are:

--A decrease in the number of farms and an increase in average farm size.

--A greater share of gross farm income going to large farms.

--A higher degree of linking, either by contract or by ownership, of two or more steps in the producing, processing, servicing, and marketing functions. This is referred to as vertical coordination.

--A larger portion of agricultural products handled by a smaller number of firms.

Following is a brief overview of the changing agricultural structure. A more detailed description is included in the Congressional Budget Office report entitled "Public Policy and the Changing Structure of American Agriculture," dated September 1978, and GAO's staff study entitled "Changing Character and Structure of American Agriculture: An Overview" (CED-78-178), dated September 26, 1978.

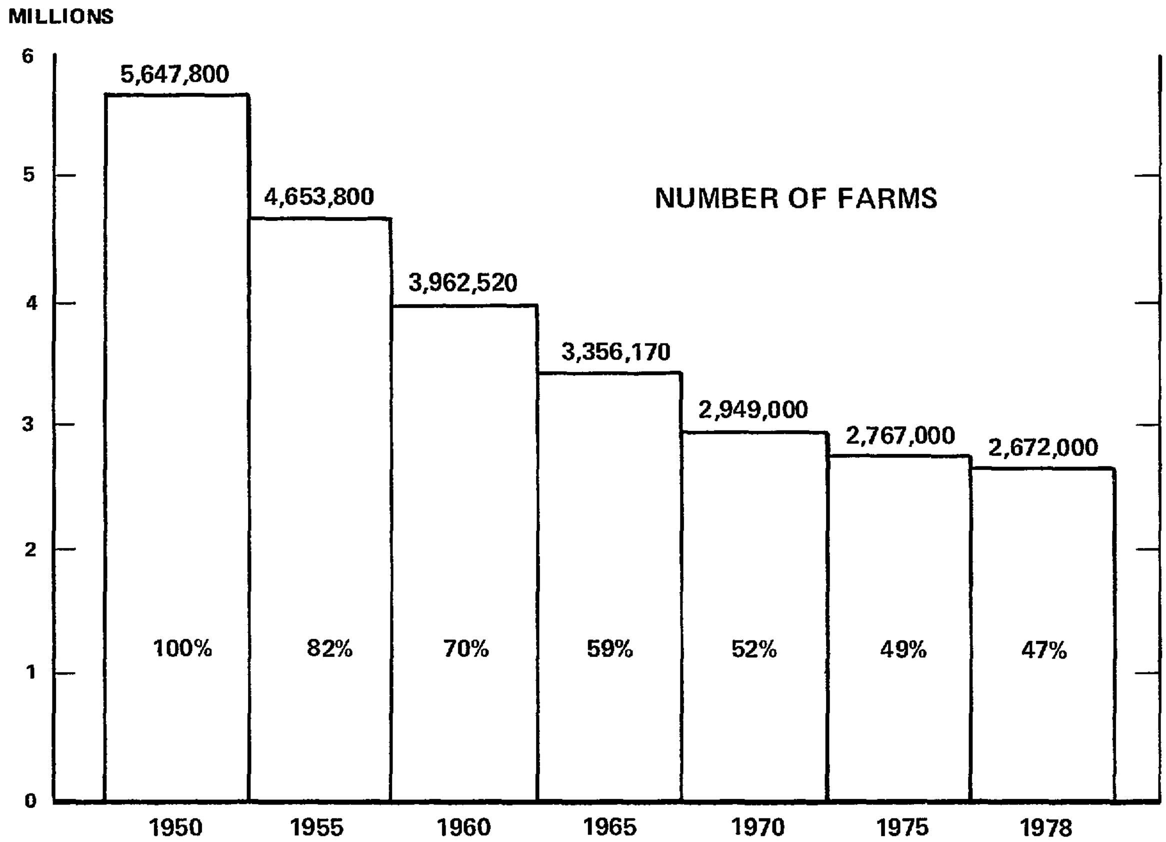
Changes in farm numbers, size, and gross farm income

Agricultural statistics show that the number of farms in the United States has steadily declined since 1950. From 1950 through 1978, the number of farms decreased about 53 percent. At the same time, the total amount of land devoted to farming decreased only about 11 percent and the average farm size increased about 88 percent. The changes in number and size of farms are depicted in the graphs on page 6.

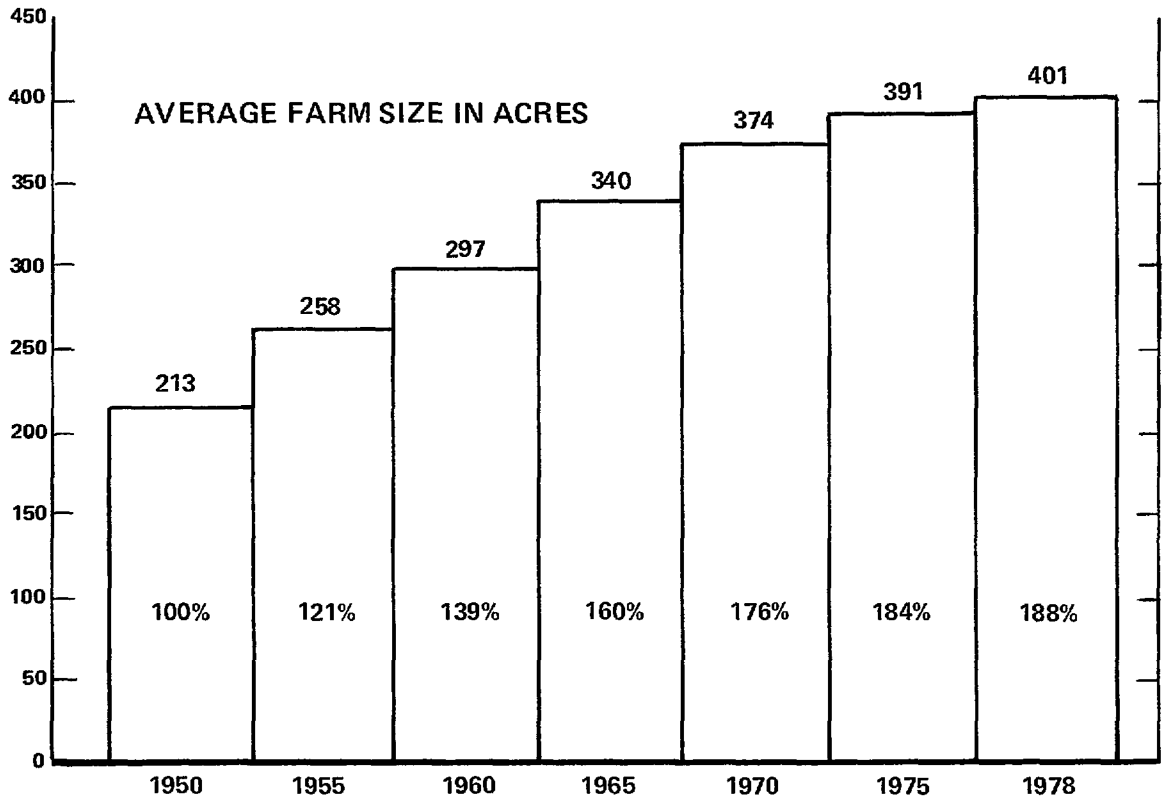
Generally, the farms going out of business have been those with the least amount of farm income. As shown in the following table, the number of farms with gross farm income under $20,000 decreased by about 1.7 million from 1960 through 1977. Because of increased prices, production efficiencies, and farm size, about 28 percent of these moved into the category of farms with gross farm income of $20,000 and over. The other 72 percent, however, went out of business. Most of these farms, particularly those with gross farm income under $5,000, had probably been operated by persons who did not depend on the farm as their primary source of income or who were living at or below the poverty level.

	Number of farms		
Gross farm income	1960	1977	Difference
Expanding farm sector:			
$100,000 and over	23,000	162,000	139,000
40,000 to 99,999	90,000	348,000	258,000
20,000 to 39,999	227,000	321,000	94,000
Total	340,000	831,000	491,000
Declining farm sector:			
$10,000 to 19,999	497,000	311,000	-186,000
5,000 to 9,999	660,000	302,000	-358,000
2,500 to 4,999	617,000	304,000	-313,000
Less than 2,500	1,849,000	958,000	-891,000
Total	3,623,000	1,875,000	-1,748,000
Total	3,963,000	2,706,000	-1,257,000

Along with the decline in farm numbers and increase in farm size has come a greater share of gross farm income going to the larger farm operators. Agricultural statistics show that from 1960 through 1977, the number of farms with gross farm incomes of $100,000 or more (unadjusted for inflation) increased from 0.6 percent to 6 percent of the total farms, while their share of total farm income increased from 17.3 percent to 52.6 percent. (See app. III for more details on the changes in farm numbers and gross farm income during the period 1960 through 1977.)



MILLIONS
NUMBER OF FARMS
5,647,800
4,653,800
3,962,520
3,356,170
2,949,000
2,767,000
2,672,000
100%
82%
70%
59%
52%
49%
47%
6
5
4
3
2
1
0
1950
1955
1960
1965
1970
1975
1978



AVERAGE FARM SIZE IN ACRES
213
258
297
340
374
391
401
100%
121%
139%
160%
176%
184%
188%
450
400
350
300
250
200
150
100
50
0
1950
1955
1960
1965
1970
1975
1978

In recent years, inflation has played an important part in the changes in farm income categories. On the basis of index numbers compiled by Agriculture's Statistics Unit, we computed that prices received by farmers increased about 95 percent from 1960 through 1977. Thus, a more accurate picture of actual changes would be a comparison of the number of farms with gross farm income of $40,000 and over in 1960 with the number of farms with gross farm income of $100,000 and over in 1977. Such a comparison shows that the number of larger farms increased from 2.9 percent to 6 percent of the total farms and their share of total farm income increased from 32.8 percent to 52.6 percent.

Vertical coordination and market concentration

The system for transferring agricultural products into table foods desired by consumers has provided an incentive for the development and growth of close vertical ties (vertical coordination) between the farm sector, input suppliers, food processors, and food distributors. The extent to which vertical coordination has taken place in agriculture varies greatly from commodity to commodity, but the overall trend is toward greater coordination. For example, during the period 1960-70, the latest information available, the proportion of total farm production under vertical coordination increased from 19 percent in 1960 to 22 percent in 1970. In 1970 the degree of vertical coordination by commodity groups ranged from 100 percent for sugar beets and sugar cane to less than 1 percent for feed grains and hay and forage. (App. IV shows the degree to which major crop and livestock commodities were vertically coordinated in 1960 and 1970, according to Department of Agriculture specialists.)

Market concentration refers to the extent to which a relatively few suppliers account for a major share of sales in a market area or commodity group. Although the extent of market concentration and the degree of change over time are not well documented, available studies and other data, some of which are summarized below, indicate that the trend is toward more highly concentrated markets for agricultural products.

--A July 1978 report by Agriculture's Economics, Statistics, and Cooperatives Service 1/ estimated that in 1975 the four largest corporations that handle grain accounted for about 40 percent of all domestic grain transactions above the local elevator level and about 75 percent of all grain exports.

--Unpublished data gathered by Agriculture's former Packers and Stockyards Administration on 23 cattle feeding States showed that, of the number of steers and heifers slaughtered in those States, the quantity slaughtered by the four largest firms operating in each State increased from 55.9 percent in 1969 to 62.8 percent in 1974. In 1974 the four-firm-concentration level ranged from 19.7 percent in California to 100 percent in North Dakota.

--A paper prepared by a Federal Trade Commission staff member and included in a March 1975 report published by the Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices, Senate Committee on Agriculture and Forestry, 2/ stated that competition in food manufacturing is increasingly controlled by a few large corporations whose special expertise includes creating new product variations, advertising and promoting them, and using field sales personnel to convince retailers to give priority shelf space to their new products.

--A 1977 report by the Council on Wage and Price Stability 3/ showed the market concentration of the

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1/"Growth of Cooperatives in Seven Industries," Cooperative Research Report 1, Economics, Statistics, and Cooperatives Service, U.S. Department of Agriculture, July 1978.

2/"The Market Functions and Costs for Food Between America's Fields and Tables." The paper entitled "Competition in Food Retailing and Manufacturing" was prepared by Russell Parker, Assistant to the Federal Trade Commission's Director for Special Projects, and begins on p. 77 of the subcommittee's report.

3/"A Study of Bread Prices," Executive Office of the President, Council on Wage and Price Stability, staff report, Apr. 1977.

large, multiregional bakers had increased since 1963 even though their prices were a few cents higher than those of the smaller bakers.

--A 1973 report by the Bureau of the Census 1/ showed that the four largest cereal manufacturers controlled 90 percent of cereal production in 1970.

--In March 1977 the Joint Economic Committee published a report 2/ which said that between 1948 and 1972 the share of grocery store sales controlled by the largest grocery chains had risen from 34 percent to 57 percent. In 1972 the four largest grocery retailers in 194 metropolitan areas accounted for an average of 52 percent of the grocery sales. In one-fourth of these metropolitan areas, they accounted for 60 percent or more of sales.

COOPERATIVES' ROLE

Cooperatives are an integral part of the agricultural structure. They provide farmers an alternative for marketing their products and procuring farm-related items and services, and opportunities to (1) store raw and finished products to increase market stability, (2) bargain collectively over the price of their products, and (3) engage in processing and retailing their products and share in the profits available in those markets. They also help, in most instances, to increase competition for agricultural products and act as a countervailing force in the marketplace.

In total, cooperatives handled about 28.6 percent of the agricultural products marketed and about 18.1 percent of farm supplies and equipment procured by farmers during crop year 1975-76--an increase from 20 percent and 12 percent, respectively, for crop year 1950-51. The cooperative share varied greatly,

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1/"Annual Survey of Manufactures 1970," Bureau of the Census, U.S. Department of Commerce, Nov. 1973.

2/"The Profit and Price Performance of Leading Food Chains, 1970-74," a study prepared for the use of the Joint Economic Committee by the members of the University of Wisconsin Food System Research Group of NC 117, Mar. 1977.

however, from commodity to commodity. For example, in crop year 1975-76, cooperatives marketed 68.4 percent of the total dairy products and only 8.3 percent of the total poultry and eggs. (Apps. V and VI show the cooperative share of the agricultural products marketed and supply items procured for crop year 1975-76.)

Cooperatives are not a homogeneous group. They differ in type of services, size of area served, volume of business, organizational form, and marketing strategies. Some cooperatives perform only marketing, bargaining, supply, or service functions; others perform a combination of two or more of these functions. Individually, cooperatives' gross volumes of business ranged from under $1 million to about $2 billion during crop year 1975-76. Each is organized as either a federated, centralized, or mixed cooperative serving a local, regional, national, or international market. The factor determining whether a cooperative is federated, centralized, or mixed is the membership. Members of a federated cooperative are other cooperatives; members of a centralized cooperative are independent agricultural producers; and members of a mixed cooperative are both other cooperatives and independent agricultural producers.

Cooperatives employ different marketing strategies to achieve their basic objectives. One of our consultants classified marketing cooperatives' strategies as (1) bargaining, (2) competitive buy-sell, (3) committed-commodity marketing, and (4) committed-integrated marketing. These strategies were defined as follows:

--Bargaining cooperatives usually do not take title to the product. They typically negotiate contract terms with first handlers or processors for the sale of agricultural commodities. These contracts are usually not binding on the producer. Instead, each producer independently decides whether to agree to the terms of the contract.

--Competitive buy-sell cooperatives operate as competitors in the spot or cash market. They are distinguished from other marketing cooperatives in that there is no legal commitment on the part of producers to market through or purchase from the cooperatives. They may or may not take title to the product.

--Committed-commodity marketing cooperatives make marketing decisions on behalf of producers. These cooperatives require written agreements with producers to market their products through the cooperatives. These agreements transfer control and often the title of the products to the cooperative which markets at the next market level and bypasses the local market pricing point. The producer is paid for the product on a pooled basis with appropriate quality or other price differential adjustments.

--Committed-integrated marketing cooperatives operate the same as committed-commodity marketing cooperatives except that they bypass two or more pricing points. They market shelf-ready products rather than commodities and are integrated into the export market.

Changes in cooperative number and size

The trend in cooperative number and size has been similar to the overall trend in other sectors of the agricultural economy--fewer in number and larger in size. For example, from 1965-66 through 1975-76, the number of cooperatives decreased from 8,329 to 7,535, or about 10 percent. During the same period, the number of cooperatives with gross annual sales of $100 million or more increased from 30 to 82, or about 173 percent. The following table shows the changes in cooperative number and size for the 10-year period.

	1965-66		1975-76		
Annual gross sales	Number of cooperatives	Percent of total	Number of cooperatives	Percent of total	Percent of change from 1965-66 to 1975-76
Under $1 million	5,634	67.6	3,157	41.9	-44
$1 to $9.9 million	2,416	29.0	3,794	50.4	57
$10 to $99.9 million	249	3.0	502	6.6	102
Over $100 million	30	.4	82	1.1	173
Total	8,329	100.0	7,535	100.0	-10

Source: Cooperatives Unit of the Economics, Statistics, and Cooperatives Service, Department of Agriculture.

As the table shows, there is a very large spread between the smallest and largest cooperatives and over 90 percent of the cooperatives in 1975-76 had gross sales under $10 million. This translates into a relatively few cooperatives accounting for a large share of the total cooperative business. For example, during crop year 1975-76, the largest 82 cooperatives (cooperatives with over $100 million in sales) collectively controlled about 44 percent of the net volume of commodities marketed and about 25 percent of the farm supplies and equipment sold by cooperatives.

Size of cooperatives compared with noncooperative businesses

An Agriculture study (see p. 8) showed that, collectively, the four largest cooperatives in seven industries--grain, fruits and vegetables, dairy products, poultry and eggs, feed, fertilizer, and petroleum--were smaller than the four largest noncooperative businesses with which they must compete for market share.

The study compared, among other things, sales, assets, and net worth of the four largest cooperatives in each of the industries studied with sales, assets, and net worth of their four largest noncooperative competitors. The results are shown in the following table.

	Cooperatives as a percent of noncooperative businesses		
	Sales	Assets	Net worth
Grain	24	28	38
Fruits and vegetables	32	24	17
Dairy products	25	12	9
Poultry and eggs	37	63	48
Feed	57	60	38
Fertilizer	15	13	7
Petroleum	3	2	2

As the table shows, in the five agricultural categories, the cooperatives' sales ranged from 24 to 57 percent of those of their competitors, assets ranged from 12 to 63 percent, and net worth ranged from 9 to 48 percent.

VIEWS ON THE IMPORTANCE OF COOPERATIVES TO FAMILY FARMERS

The view of many knowledgeable people is that family farmers need the right to act together through cooperatives if many are to survive under the current agricultural structure.

Our consultants told us that many of the problems facing independent family farmers today are basically the same as they were in the 1920s and 1930s when the basic cooperative legislation was enacted. A basic problem that still exists is the imbalance of market power of farmers acting individually in the marketplace. The Secretary of Agriculture and others concur in this position. Examples of this view follow.

In Agriculture's April 11, 1977, policy statement on cooperatives, the Secretary said that cooperatives were absolutely necessary for family farmers to compete with other sectors of the highly organized business economy. More recently, in testimony on July 27, 1978, before the President's National Commission for the Review of Antitrust Laws and Procedures, 1/ the Secretary said that the only realistic hope that farmers have for some equity in the market is through effective cooperation. He said that the buyers' side of the agricultural product markets has gained tremendous strength because of increased size of buyers while the producers' side is still made up largely of individual farmers who, to a considerable degree, are faced with the same problems that existed in the late 19th and early 20th centuries.

In testimony on Agriculture's fiscal year 1977 budget, the current head of the Cooperatives Unit said that the lack of the small producer's ability to deal with large buyers and sellers is greater today than ever. He said that cooperatives stand as the only significant check against complete dominance of our food industry by large corporations.

In a September 1975 report, the Federal Trade Commission staff 2/ said that a reasonable inference is that small

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1/The National Commission for the Review of Antitrust Laws and Procedures was established by Executive Order 12022, Dec. 1, 1977, to study and make recommendations on (1) the revisions of procedural and substantive rules of law needed to expedite the resolution of complex antitrust cases and development of proposals for making the remedies available in such cases more effective and (2) the desirability of retaining the various exemptions and immunities from the antitrust laws, including exemptions for regulated industries and exemptions created by State laws that inhibit competition.

2/"Staff Report on Agricultural Cooperatives," Federal Trade Commission, Sept. 1975.

agricultural producers might be relegated to a position of relative impotence by the loss of the cooperative form of organization, allowing more corporations to enter agricultural production. It said that a higher degree of concentration and an increase in vertical integration would result from this.

Further, an official in the Justice Department's Antitrust Division told us that, generally speaking, cooperatives should continue to exist because farmers are still in the disadvantageous position they were when the Capper-Volstead Act was passed. He said that cooperatives have done a great deal to help farmers obtain competitive prices for their commodities.

Moreover, the majority of the farmers responding to our questionnaire viewed cooperatives as increasing the income and promoting a better way of life for family farmers and equally serving the needs of both small and large farming operations. (See app. II.) Most of them believed that family farmers needed cooperatives to remain in farming. For example, of the 382 farmers responding to our question on the extent to which family farmers need marketing cooperatives in order to remain in farming, 34.3 percent checked "to a very great extent," 27.7 percent checked "to a substantial extent," and 26.2 percent checked "to some or to a moderate extent." Only 11.8 percent checked "to a little or no extent." With some exceptions, the responses were similar regardless of the (1) type of commodity produced, (2) section of the country, (3) size of farming operation, and (4) age of the farmer.

CHAPTER 3

BETTER ADMINISTRATION NEEDED OF LEGISLATION

CONTROLLING COOPERATIVE ACTIVITIES

As cooperatives have grown in both size and market share, they have come under increasing attack by those who would strip them of some of their legislated advantages. Critics have charged that some cooperatives have used their legislated rights and privileges to gain market power and have increased prices. There is little documented evidence that cooperatives have abused their legal rights to gain market power. According to our consultants, however, a few cooperatives could be viewed as having the potential to do so.

The Department of Agriculture has done very little to carry out its legislative responsibilities to control cooperatives' activities. Better administration of the undue price enhancement provision of the Capper-Volstead Act of 1922 and of the unfair trade and unfair marketing practices provision of the Agricultural Marketing Agreement Act of 1937 could help to ensure a competitive agricultural system and to clarify Federal policy regarding cooperatives. Moreover, it may be critical to family farmers that existing laws protecting against cooperative abuses of market power be properly enforced. Without such enforcement to instill public confidence, legislation may be passed which could adversely affect the cooperatives' ability to sustain competitive growth and development. Recently, Agriculture took action to improve its oversight of cooperative activities, but more could be done.

CONCERNS EXPRESSED ABOUT COOPERATIVE ACTIVITIES

The Federal Trade Commission staff, the Department of Justice, and others have charged in recent years that some cooperatives are in a position to use their legislated rights and privileges to gain undesirable market power and are a threat to competition in some sectors of the agricultural economy. They say that cooperatives have used marketing orders, marketing agencies in common, and mergers to gain market power which is undesirable to the Nation. Legislative changes have been suggested to curtail the cooperatives' activities in these areas. According to some economists, these suggestions, if adopted, could also adversely affect the cooperatives' ability to serve family farmers. Also, cooperative officials are confused as to what activities could be subject to legal action by the Federal

Government and, because of this, some cooperatives may have passed up opportunities to serve family farmers better.

In a September 1975 report on agricultural cooperatives (see p. 13), the Federal Trade Commission staff charged that in a few industries a number of cooperatives had acquired significant economic power. According to the report, single cooperatives dominated the national or regional markets within the following industries: milk, lemons, oranges, cranberries, grapes (Concord), clingstone peaches, pears (Bartlett), walnuts, almonds, raisins, prunes, and winter celery. The report pointed out that, except for the Concord grape industry, each market dominated by a single cooperative was regulated by a Federal and/or State marketing order. It said that these cooperatives require close scrutiny because marketing orders, which are legal instruments designed among other things to (1) enhance and/or stabilize farm prices, (2) eliminate unreasonable fluctuations in farm production, and (3) control the quantity of agricultural commodities sent to market, could be used by cooperatives for market manipulations with undesirable economic effects.

The report also said that cooperatives' antitrust exemptions do not expressly exempt intercooperative mergers, acquisitions, joint ventures, marketing agencies in common, and other intercooperative combinations and conspiracies from antitrust scrutiny. It set forth the following propositions:

--The Clayton and Capper-Volstead Acts expressly authorize only the formation, existence, and ordinary operation of cooperatives as business organizations handling the products of agricultural producers.

--Cooperatives have the same status that corporations have under the antitrust laws.

--Cooperatives should be subject to prosecution under the antitrust laws whenever they combine or conspire to restrain trade, enter into acquisitions and mergers that tend to create monopolies, or monopolize.

A January 1977 Department of Justice report on milk marketing said that some dairy cooperatives had used intercooperative mergers; federations and marketing agencies in common; marketing orders; and other tactics, such as full supply contracts and vertical integration, to achieve and exercise monopolistic market power--the power to raise prices. It is clear, the report said that the anticompetitive activities of cooperatives have exceeded the potential for such activities which the Congress envisioned in 1922 when it passed the Capper-Volstead Act.

Regarding the cooperatives' antitrust exemptions, Justice said that intercooperative associations are subject to antitrust scrutiny when they are predatory, monopolistic, or other than marketing in nature. Contrary to the position of the Federal Trade Commission's staff that intercooperative mergers are not exempt from antitrust scrutiny, Justice said that the law is not clear. Justice suggested that the law be changed to apply specifically to cooperative mergers. It also suggested that the "marketing agencies in common" provision of the Capper-Volstead Act be defined and limited in scope.

In a January 1979 report, the National Commission for the Review of Antitrust Laws and Procedures (see p. 13) concluded that some cooperatives have the potential to gain monopoly market power. The commission recommended that mergers, marketing agencies in common, and similar agreements among cooperatives should be disallowed if competition would be substantially reduced. Such action could weaken the cooperatives' ability to sustain the growth and development needed to stay competitive.

A member of the commission's Economic Advisory Panel, in commenting on the commission's recommendation, said that it would be extremely difficult to persuade the courts to balance the public policy objective of increasing farmers' marketing power with the standard for substantial lessening of competition. To subject cooperative mergers to that standard, he said, would cause a lot of problems for cooperatives because they would be investigated and probably challenged for mergers which are not likely to have significant anticompetitive effects. Also, he said that steps which seriously weaken the market position of cooperatives while doing nothing about market power elsewhere in the economy would place farmers at a serious competitive disadvantage. Our consultants concur in this position.

Also, our consultants told us that, because of the views expressed by the Federal Trade Commission and the Department of Justice, cooperatives are confused as to what Federal policy is regarding cooperatives and that this may have been counterproductive to the Nation's policy to encourage cooperative development. Indications of such confusion and its impact were reflected in statements made by cooperative officials during our review. Examples of these statements follow.

--The time and effort required to justify cooperative activities to the Federal Trade Commission and the Department of Justice has been a major problem.

--Agriculture's work to assist cooperatives has been neutralized in part by what some cooperative officials see as Federal Trade Commission, Department of Justice, and Securities and Exchange Commission competition for regulatory jurisdiction.

--One cooperative decided not to expand its market share because of uncertainty about whether the Federal Trade Commission or the Department of Justice would take legal action. At the time of our visit, the cooperative controlled about 50 percent of the national market share of the commodity handled.

--Another cooperative passed up two opportunities to become more self-sufficient in the manufacturing of products it desired to handle, largely because of possible legal action by the Federal Trade Commission.

AGRICULTURE'S ADMINISTRATION OF LEGISLATION TO PROTECT AGAINST ABUSE OF MARKET POWER HAS BEEN INADEQUATE

The Capper-Volstead Act authorizes and the Agricultural Marketing Agreement Act of 1937, as amended, permits the Department of Agriculture to take steps to ensure that cooperatives do not use their legislated rights and privileges to the detriment of others. Agriculture has not done all that it should to monitor and control cooperative activity and to protect the public interest.

The Capper-Volstead Act

Section 2 of the Capper-Volstead Act provides that, if the Secretary of Agriculture has reason to believe that any cooperative monopolizes or restrains trade to such an extent that the price of any agricultural product is unduly enhanced, he shall serve a complaint on such association, including a notice of a hearing. The association will be required to show cause why it should not be directed to cease and desist from such monopolization or restraint of trade practice.

Up to now, Agriculture has relied solely on the receipt of outside complaints before taking action to determine whether cooperatives have monopolized or restrained trade to such an extent that the prices of agricultural commodities were unduly enhanced. By interviewing Department officials and reviewing Department files, we identified that since the inception of the Capper-Volstead Act, five undue price enhancement complaints have been received. The first of these was in 1969; the latest, in 1976.

The Department investigated four of the complaints. It refused to investigate the other one because the charges made were substantially encompassed in an antitrust action that the Department of Justice had taken against the cooperative. In each of the four cases it investigated, Agriculture concluded that the cooperatives had not unduly enhanced commodity prices.

While we cannot say whether Agriculture's conclusions were right or wrong in those specific cases, we noted that the investigations had been made without official criteria for determining when prices could be considered unduly enhanced and without formal guidelines for conducting the investigations. In its report on the last complaint, however, Agriculture outlined several marketing and pricing factors that would be relevant to determining if prices were unduly enhanced and appeared to have made a more comprehensive investigation than those in the other three cases.

In testimony on July 27, 1978, before the National Commission for the Review of Antitrust Laws and Procedures, the Secretary of Agriculture said that the Department conducted very few investigations because, as a rule, cooperatives were relatively small until the 1960s and farm prices were low until the early 1970s. He also said that, although it is questionable whether the larger regional cooperatives have achieved strong marketing positions, the Department is concerned about how best to carry out its section 2 responsibilities and has agreed, among other things, that cooperative activities must be monitored for possible instances of undue price enhancement.

We discussed Agriculture's investigations in the four cases with several Agriculture officials and expressed concern that the present system does not adequately assure the public that cooperatives have not unduly enhanced the prices of agricultural products. They generally agreed with our observations.

In August 1978, the Administrator of the Economics, Statistics, and Cooperatives Service appointed an interagency committee to examine Agriculture's role in carrying out its responsibilities under section 2 of the Capper-Volstead Act. The committee was assigned responsibility for examining and making recommendations in areas such as:

--Criteria for determining undue price enhancement.

--Mechanisms for monitoring and/or investigating the possibility that prices were being unduly enhanced.

--Alternative procedures for monitoring cooperative pricing activity.

--Data bases, data sources, and data gaps for carrying out the monitoring function.

Some have questioned whether the Department can effectively regulate cooperatives and at the same time promote their growth and development through educational, research, and technical assistance programs. In its January 1979 report, for example, the National Commission for the Review of Antitrust Laws and Procedures expressed concern with the policy of charging the same organization with both promotional and enforcement responsibilities with respect to cooperatives and recommended that the responsibilities be separated either within or outside the Department of Agriculture. We agree that these functions should be separated to avoid conflicts of interest and allow each function to be effectively and vigorously pursued.

The National Commission further recommended that section 2 of the Capper-Volstead Act be amended to define more precisely "undue price enhancement." We agree that the term needs to be defined.

The Agricultural Marketing Agreement Act

The Agricultural Marketing Agreement Act of 1937, as amended, authorizes the Secretary of Agriculture to include in marketing orders terms and conditions prohibiting unfair methods of competition and unfair trade practices. Agriculture officials told us that for many years Ariculture had not exercised this authority and that none of the existing marketing orders included such terms and conditions. They said that they did not see the need for exercising this authority because any potential unfair trade or unfair marketing practice could be challenged under the antitrust laws. We believe that specifically mentioning in the marketing orders the trade or marketing practices that are prohibited could discourage cooperatives from engaging in such practices and would provide a more effective basis for taking administrative or legal action should such practices occur. This could also forestall action by third parties which could seriously injure the financial well-being of some cooperatives.

In our consultants' opinion, certain operating practices, if engaged in by cooperatives, could result in unfair methods of competition or constitute unfair trade practices, particularly in the markets controlled by marketing orders where cooperatives have a dominant share and entry barriers into production are high. Examples of practices cited were

(1) devices used to control total production of members, such as exclusive supply requirements restricting opportunities for members to expand their scales of operations, (2) closed membership policies for reasons other than capacity utilization, physical efficiency of operation, or lack of product market, (3) marketing agreements between cooperatives and their members which exceed normal industry practices and are not necessary to maintain liquidity and solvency, (4) joint ventures and other intercooperative relationships that have undue price enhancement implications, (5) joint pricing activities of cooperatives that perform both bargaining and processing functions in the same market, (6) practices which have the effect of coercing producers to join cooperatives, and (7) practices, other than normal business practices, which have the effect of removing competitors from a market.

Our consultants pointed out that the practices enumerated above would not necessarily restrain trade under all circumstances. Depending on marketing conditions, some could be procompetitive rather than anticompetitive.

Documented examples cannot be cited where cooperatives are now engaging in unfair methods of competition or unfair trade practices; however, a few cooperatives have engaged in such practices in the past. Moreover, some cooperatives may have the power and opportunity to do so in the future. To deal with such potential problems and abuses and to help clarify Federal policy regarding cooperative activities, Agriculture should establish with the Federal Trade Commission and the Department of Justice a general set of cooperative conduct principles. Our consultants suggested the following principles for consideration.

--Cooperatives shall not limit or set up devices which have the effect of controlling the total quantity of production of their members.

--Cooperatives shall not restrict their membership except where such restrictions are demonstrably necessary for reasons of capacity utilization, physical efficiency of operation, or lack of market.

--The duration of marketing agreements between cooperatives and their members shall not exceed normal industry practices except where demonstrably necessary to maintain liquidity and solvency.

--Cooperatives shall not engage in any practices which will have the effect of coercing producers to join cooperatives.

--Cooperatives shall not engage in any practices that will have the effect of removing competitors as a competitive element in a market.

--Cooperatives shall not establish supply contracts with buyers when the effect of such contracts will eliminate a market outlet for noncooperative producers or competitive marketing firms.

--Cooperatives have the obligation whenever feasible to maintain an open competitive market for all producers.

Once such conduct principles are developed, Agriculture should use them as a guide for determining terms and conditions for future marketing orders. We recognize that, in any single order, some of the general principles may need to be revised considerably to meet specific commodity needs and conditions and that others may not be applicable. Further, although our review scope was limited to cooperatives, we recognize that such principles may also be applicable to practices engaged in by other handlers covered by the marketing orders.

CONCLUSIONS

The Department of Agriculture took an important first step to improve its administration of section 2 of the Capper-Volstead Act by initiating a study to examine and make recommendations in such areas as

--criteria for determining undue price enhancement,

--mechanisms for monitoring and/or investigating possible instances of undue price enhancement,

--procedures for monitoring cooperative pricing activity, and

--data base and sources for carrying out the monitoring function.

However, if the regulatory function is to remain in Agriculture, it should be set up within an agency entirely separated from Agriculture's cooperative promotional functions.

Also, Agriculture should develop jointly with the Federal Trade Commission and the Department of Justice a general set of cooperative conduct principles. Such a set of principles should help to clarify the Federal policy regarding cooperatives and thereby allow cooperatives to develop overall market and growth strategies to serve family farmers better. Moreover, in instances where marketing orders are initiated--particularly for markets that have strong cooperatives--the principles should be tailored to the specific commodity and marketing situations and included in orders as terms and conditions to prohibit unfair trade and marketing practices.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that the Secretary of Agriculture:

--Establish, under the control of an agency separate from cooperative promotional functions, an enforcement and monitoring system to ensure that cooperatives do not raise prices unduly. At a minimum, the system should include (1) criteria for defining undue price enhancement, (2) mechanisms for monitoring pricing activity of cooperatives, and (3) procedures for investigating and dealing with instances where prices may have been unduly enhanced.

--Develop jointly with the Federal Trade Commission and the Department of Justice a general set of cooperative conduct principles.

--Include specifically tailored conduct principles as terms and conditions in all future marketing orders, unless a determination is made that they are not warranted because of marketing conditions.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Agriculture agreed that an enforcement and monitoring system is needed to ensure that cooperatives do not raise prices unduly. (See app. VII.) It said that it was proceeding to establish a formal system which would be administered independently of Agriculture's information and assistance responsibilities to cooperatives.

In June 1979, the interagency committee issued a report on its study to improve the administration of section 2 of the Capper-Volstead Act. (See p. 19.) The report is in line with our findings.

Agriculture disagreed, however, with our recommendation on developing cooperative conduct principles and including them in future marketing orders. It pointed to the lack of documented examples where cooperatives are now engaging in unfair methods of competition or unfair trade practices and concluded that if instances cannot be cited where cooperatives have engaged in such practices since 1937--the year the Agricultural Marketing Agreement Act was enacted--there is little reason to believe such principles are needed. It said also that a set of laws applying to cooperatives and other businesses regarding such conduct already exists.

Concerning the relationship between marketing orders and cooperatives, Agriculture said that cooperatives play an important role in milk orders but strong cooperatives are present in only a few of the over 30 fruit and vegetable commodities covered by marketing orders. It added that cooperatives do not exist under some fruit and vegetable orders and exist only coincidentally under most others.

Agriculture also said that using the unfair practice provision of the Agricultural Marketing Agreement Act to prohibit unfair trade practices would be undesirable because that provision is incidental and there was no indication that it was intended to be used as a tool to police cooperatives' conduct. It suggested that if the provision is to be used as a policing tool, there should be some new legislative authorization. Agriculture further said that some of the conduct principles suggested by our consultants covered illegal practices and others were too vague to be operational.

We recognize that strong cooperatives are not present in all commodities covered by marketing orders and that some of the conduct principles suggested by our consultants may cover illegal actions and others may need to be revised for clarity. However, a few cooperatives have engaged in unfair practices in the past, and we believe that the potential for some cooperatives to engage in such practices in the future warrants inclusion of specifically tailored conduct principles in marketing orders. We believe also that the Secretary can carry out this action under his existing legislative authority.

Single cooperatives dominate some of the national or regional markets and, as such, may have the opportunity to engage in unfair trade or marketing practices. Specifically mentioning in the marketing orders the practices that are prohibited, even those that are already antitrust violations, would serve as a reminder to the cooperatives and give them more specific notice of practices that could incur legal action. This could discourage cooperatives from engaging in such practices and would provide a more effective basis for taking administrative or legal action should such practices occur. Moreover, a comprehensive set of conduct principles jointly developed by the three oversight agencies should help to clarify the now-confusing Federal policy regarding cooperatives and thereby allow cooperatives to serve family farmers better.

Agriculture agreed with our consultants that certain behavior may be undesirable in some markets and desirable in others. It said that it would appear prudent to permit certain action unless the results are undesirable, as is consistent with our legal system. Our recommendation agrees with this position.

The Federal Trade Commission staff said that it believed our recommendation on developing conduct principles may have merit but that there are inherent limitations on the usefulness of such principles. (See app. VIII.) It said that while the principles suggested by our consultants, several of which it endorsed, may be useful in setting broad parameters within which cooperatives may operate, the fact that many of them were broad and vague raised doubt as to whether they would provide totally satisfactory guidance for a cooperative's day-to-day operation. It added that another difficulty with broad, general principles is that they may unnecessarily impede cooperatives' activities. The staff said that it recognized, however, that the suggested principles were presented only as a starting point for discussion.

The Commission staff said that it did not believe that a comprehensive and specific set of antitrust rules could be developed because of the wide variety of markets within which cooperatives operate and the substantial differences among individual cooperatives in terms of their methods of operations and their economic significance in various markets. It said, however, that it would be happy to work with Agriculture and Justice to develop conduct principles, although their inherent limitations should be clearly understood before the project is undertaken. The staff said that further issues to be explored were the legal significance of including conduct principles as terms and conditions in marketing orders and how a decision would be made that they were not warranted because of marketing conditions.

As the Commission staff recognized, the principles suggested by our consultants were presented only to begin discussion. We realize the difficulty the agencies will encounter in trying to develop a useful set of conduct principles for dealing with possible abuses of cooperative market power without unnecessarily impeding cooperative activities designed to serve family farmers better. We are encouraged, however, by the Commission staff's willingness to work jointly with Agriculture and Justice to develop a set of conduct principles.

Regarding the legal significance of including such principles in marketing orders, an approved marketing order is a legal document, and all handlers, including cooperatives, subject thereto may be fined for violating any of its provisions. Before an order is issued, the Secretary of Agriculture is required to give notice and an opportunity for a hearing. Anyone, including the Federal Trade Commission, could introduce evidence at such hearings to show cause why a marketing order should or should not include terms and conditions for prohibiting unfair practices. Moreover, the system being developed by Agriculture for monitoring cooperatives for instances of undue price enhancement could help the Secretary to determine whether such terms and conditions would be warranted.

In commenting on certain statements made by cooperative officials (see pp. 17 and 18), the Commission staff said that

--the Commission has not and does not seek to regulate cooperatives,

--the threat of legal action would seem to be an effective antitrust deterrent in the case where the cooperative controlled about 50 percent of the market for a particular commodity, and

--more information was needed to determine whether the two opportunities the cooperative passed up to become more self-sufficient in the manufacturing of products it desired to handle might have had anticompetitive effects.

We used the cooperative officials' statements only to illustrate the need for clarifying Federal policy regarding cooperatives. We did not intend to imply that the Federal Trade Commission, the Department of Justice, and the Securities and Exchange Commission were, in fact, competing for regulatory jurisdiction over cooperatives or that the cooperatives in the cited examples were unnecessarily penalized. The report has been clarified.

The Department of Justice agreed that independent family farmers need to continue to act together through cooperatives for the joint marketing of their products. (See app. IX.) However, it said that the Capper-Volstead Act creates the potential for cooperative monopoly and that more needs to be done to prevent, eliminate, or even monitor cooperative activities to guard against undue price enhancement and other unfair practices. In addition to supporting our recommendation to improve enforcement of the undue price enhancement provision of the Capper-Volstead Act, Justice said that cooperative mergers and common marketing agencies should be disallowed when they may substantially eliminate competition.

We agree that better controls are needed to ensure that cooperatives do not unduly enhance the prices of agricultural products and engage in unfair trade and marketing practices. However, in deciding the specific steps to be taken, the legal right of farmers to use cooperatives to obtain fair and competitive prices for products marketed and for supply and equipment items procured should not be jeopardized.

Our consultants and others believe that to subject cooperative mergers to the standard for substantial lessening of competition would result in cooperatives being investigated and probably challenged on actions which would not have significant anticompetitive effects and could adversely affect the cooperatives' ability to serve family farmers. On the other hand, Justice believes that the peculiar characteristics of cooperative marketing and agricultural production would be taken into account in any determination of the competitive impact of intercooperative action and farmers would not be placed at a serious competitive disadvantage.

We have not concluded, as Justice said we did, that legislative action concerning cooperative mergers, marketing agencies in common, or other agreements was unwarranted under all circumstances. We believe, however, that development of a more effective system for enforcing the undue price enhancement provision of the Capper-Volstead Act, along with equitable enforcement of the antitrust laws and the unfair trade and marketing practices provision of the Agricultural Marketing Agreement Act, could negate the need for legislative changes.

Justice said that its Antitrust Division was participating in the interagency task force to examine Agriculture's role in carrying out its responsibilities under section 2 of the Capper-Volstead Act. It said that two important issues being discussed were the appropriate definition to be used for identifying when cooperatives (1) engaged in monopolization and (2) unduly enhanced prices. It also said that its Antitrust Division had advised the task force that:

--Monopolization consists of the possession of monopoly powers in the relevant market and the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.

--Undue price enhancement should be broad enough to include both increases and maintenance of prices at levels higher than those that would exist if there were no restrictions on entry into the market.

We commend the Antitrust Division's participation in the interagency task force to help the Department of Agriculture develop a better system for carrying out its responsibilities under section 2 of the Capper-Volstead Act. Also, we agree that developing appropriate definitions for "monopolization" and "undue price enhancement" will play an important role in the ultimate effectiveness of the system under development.

Regarding our recommendation concerning cooperative conduct principles, Justice said that it is unlikely that a meaningful code of conduct could be developed to cover all commodities and, at the same time, assure that competitive vigor in a particular commodity would not be artificially and unduly limited. It said that the competitive impact of conduct can differ because of such factors as the product and geographic area involved, the size of the firm involved, and the competitive structure of the market. It said that there may be instances, however, where the Secretary of Agriculture would want to tailor specific marketing orders to prohibit certain conduct.

We recognize that the competitive impact of a marketing practice depends on many factors and care must be taken not to develop conduct principles that would artificially and unduly limit competition. In spite of this, we believe that an attempt should be made to develop a general set of conduct principles setting forth broad parameters within which all cooperatives may operate and that, when warranted, specifically tailored conduct principles should be included as terms and conditions of marketing orders.

CHAPTER 4

NONFAMILY FARM CORPORATIONS ARE PERMITTED

TO JOIN COOPERATIVES: SHOULD THEY BE?

An issue of major concern to the Nation is the involvement of large, diversified corporations in the production of agricultural products and their impact on family farmers. Section 102 of the Food and Agriculture Act of 1977 (Public Law 95-113, 91 Stat. 918) states that the Congress believes that (1) maintenance of the family farm system of agriculture is essential to the social well-being of the Nation and the competitive production of adequate supplies of food and fiber and (2) any significant expansion of nonfamily owned, large-scale corporate farming enterprises would be detrimental to the national welfare.

The legislative history of the Capper-Volstead Act indicates that the act was designed to enable independent family farmers to achieve through cooperative action some of the same advantages available to businessmen using the corporate form of business organization. Under the act, however, nonfamily farm corporations engaged in the production of agricultural products may join cooperatives. Whether nonfamily farm corporations should continue to have this right is an emerging policy issue.

As far as we could determine, this issue has never been addressed by the Congress. Any changes involving this issue would require legislative action. Some of the factors the Congress should consider in deciding the action to be taken are (1) the extent of corporate involvement in the production of agricultural products, (2) the extent of corporate involvement in cooperatives, (3) how farmers feel about nonfamily farm corporations being members of cooperatives, and (4) the advantages and disadvantages of allowing nonfamily farm corporations to participate in cooperatives.

CORPORATE INVOLVEMENT IN AGRICULTURAL PRODUCTION

For the 1974 Census of Agriculture, the Bureau of the Census, Department of Commerce, for the first time conducted a special survey of corporations involved in agricultural production. The survey showed that there were 28,442 corporate farms in 1974. They accounted for about 1.7 percent of all farms, about 10.6 percent of the land in farms, and about 18.2 percent of the value of agricultural products sold.

These corporate farms owned or rented an average of 3,377 acres of land per farm, or about 6 times the average for commercial farms. Twenty-one percent of all corporate farms were located in California, Florida, and Texas. Ninety-three percent had 10 or fewer shareholders. Between 1969 and 1974, the number of farms operated by corporations with 10 or fewer shareholders increased 30 percent, and farms operated by corporations with more than 10 shareholders increased 8 percent. Their value of product sales doubled and tripled, respectively, from 1969 to 1974. The corporations with more than 10 shareholders were heavily involved in feed cattle, certain fruits and vegetables, turkeys, nursery and greenhouse products, and sugarcane.

It is likely that many of these corporate farms are, in fact, family farms 1/ that have been incorporated for tax purposes or other business reasons. While we cannot determine how many corporate farms met all the requirements of a family farm, we noted that 20,282, or about 71 percent, of the 28,442 corporate farms were family-owned farms in which farming accounted for 50 percent or more of the corporate receipts. These farms accounted for about 71 percent of the land in corporate farms and about 48 percent of the value of products sold by corporate farms.

On the other hand, the remaining 8,160 corporate farms would fall outside the criteria of a family farm. Collectively, these farms accounted for about 0.5 percent of all farms, about 3 percent of the land in farms, and about 9.4 percent of the value of agricultural products sold. Other characteristics and selected data on these nonfamily farm corporations are summarized in the following table.

1/According to the Department of Agriculture, no existing operational definition of a family farm is completely satisfactory for policy purposes. However, a common view of a family farm is one operated by a farmer and his family where the farmer provides much of the labor, makes most of the management decisions, assumes most of the risk, and reaps the gains or losses.

	Number of farms	Land in farms: Total acres (000 omitted)	Land in farms: Average acres per farm	Value of products sold: Total sales (000 omitted)	Value of products sold: Average sales per farm
Primary-farm firms (note a):					
Privately owned--independent (note c)	4,224	9,048	2,142.0	$3,077,967	$ 728,685
Privately owned--parent (note d)	314	4,263	13,576.4	804,170	2,561,051
Publicly owned--independent (note c)	60	75	1,250.0	137,546	2,292,433
Publicly owned--parent (note d)	102	536	5,254.9	651,055	6,382,892
Total primary-farm firms	4,700	13,922	2,962.1	$4,670,738	993,774
Business-associated firms (note b):					
Privately owned--family	1,476	2,810	1,903.8	296,036	200,566
Privately owned--independent (note c)	705	1,098	1,557.4	207,533	294,373
Privately owned--parent (note d)	494	5,270	10,668.0	484,931	981,642
Publicly owned--independent (note c)	126	354	2,809.5	109,632	870,095
Publicly owned--parent (note d)	659	4,773	7,242.8	1,833,948	2,782,926
Total business-associated firms	3,460	14,305	4,134.4	2,932,080	847,422
Total nonfamily-farm firms	8,160	28,227	3,459.2	$7,602,818	931,718

a/A farm corporation that earned 50 percent or more of its corporate receipts from farming.

b/A farm corporation that earned less than 50 percent of its corporate receipts from farming.

c/A farm corporation without any interlocking ownership or control with another corporation and not a family-owned corporation.

d/A farm corporation owning or controlling another corporation.

Source: 1974 Census of Agriculture.

The above table shows that, as a rule, nonfamily farm corporations are very large farming units and the largest are the most diversified. For example, nonfamily farm corporations sold an average of about $932,000 of agricultural products annually and the publicly owned primary farm firms that either owned or controlled other corporations had average sales of about $6.4 million annually, or over 6 times greater than the overall average. Moreover, the publicly owned business-associated firms that owned or controlled other corporations had average sales about 3 times greater than the average sales of all nonfamily farm corporations. The average sales of the privately owned corporations that either owned or controlled other corporations were somewhat smaller than their publicly owned counterparts, but they still had sales greater than the average for all nonfamily farm corporations.

CORPORATE INVOLVEMENT IN COOPERATIVES

The extent and nature of involvement in cooperatives by nonfamily farm corporations was the subject of a recent study funded by the Department of Agriculture and Texas A & M University. Other than this study, very little factual information is available on the subject. The study results indicate that corporate involvement, while substantial in some cooperatives, is not widespread at the present time. The study scope and results are discussed below.

Study scope

The study was conducted in two stages. In stage I, questionnaires were sent to 993 cooperatives, including the largest 120 regional cooperatives, for information on (1) organizational structure, (2) voting policies, (3) financial matters, and (4) number of members classified as other cooperatives, producers whose primary business is farming or ranching, and producers whose primary business is other than farming or ranching and classified as publicly held corporations, closely held corporations, and limited partnerships. A total of 703 cooperatives, or about 71 percent, responded to the questionnaire.

In stage II, questionnaires were sent to the 218 cooperatives that had indicated that they had (1) publicly held or other corporate members or (2) members whose primary business was other than farming or ranching. This questionnaire was designed to gather more detailed information on those members and the extent of their participation on the cooperatives' boards of directors and executive committees. A total of 147 of the 218 cooperatives, or about 67 percent, responded to the questionnaire.

The 993 cooperatives were categorized into 10 groups, as follows.

Cotton
Dairy
Fruits and vegetables
Grain
Livestock
Poultry
Rice
Sugar
Other commodities
Farm supplies

Study results

The study results showed that of the 703 cooperatives surveyed, 32 cooperatives had 421 publicly held corporate members and 66 cooperatives had 5,202 other corporate members--closely held corporations and limited partnerships. 1/ Eleven of the 32 cooperatives that had publicly held corporate members and 15 of the 66 cooperatives that had other corporate members were among the largest 120 cooperatives. These largest cooperatives had over 50 percent of the total corporate membership in cooperatives.

The study results also showed that publicly held corporations were represented on the boards of directors in 12 of the 32 cooperatives in which they had membership. Other corporations were represented on the boards of directors in 37 of the 66 cooperatives in which they had membership.

Nonfamily farm corporations were members of at least one cooperative in each of the groups surveyed but, as indicated in the following table, they were more prevalent in fruits and vegetables, grain, cotton, poultry, livestock, and farm supplies. Within these groups were 78 of the 98 cooperatives that had corporate members and 5,188 of the 5,623 corporate members.

Commodity group	Cooperatives with publicly held corporate members: Number of cooperatives	Number of members	Cooperatives with other corporate members: Number of cooperatives	Number of members
Cotton	3	16	8	783
Dairy	1	1	4	163
Fruits and vegetables	10	97	19	1,388
Grain	5	64	12	1,053
Livestock	2	7	2	521
Poultry	1	61	1	504
Rice	-	-	1	75
Sugar	1	4	5	94
Other commodities	2	5	6	93
Farm supplies	7	166	8	528
Total	32	421	66	5,202

1/The study authors stated that it was believed that some family farm corporations were included in this group but no effort was made to verify that assumption.

FARMERS' VIEWS

In the questionnaire we sent to farmers, we asked under what circumstances a nonfamily farm corporation should be permitted to be a cooperative member. The farmers responding to this question had mixed views. Overall, 55.5 percent said they should always be permitted to join cooperatives regardless of the amount of gross farm sales, and 30.4 percent said that they should not be permitted to join cooperatives. The remaining 14.1 percent said they should have the right to join if gross farm sales were under a stated amount, usually $500,000. (See app. II.)

Our analysis of the responses, by primary commodity produced and by State located, showed several variances from the overall statistics, such as (1) a somewhat larger portion of farmers growing cotton, fruits and nuts, and general products and farmers from California believed that nonfamily farm corporations should always be permitted to join cooperatives, (2) a somewhat larger portion of the poultry farmers and farmers from Minnesota believed that nonfamily farm corporations should never be permitted to join cooperatives, and (3) a somewhat larger portion of the farmers growing vegetables and melons believed that nonfamily farm corporations should have the right to join cooperatives if their farm sales were under $500,000.

An application of the chi-square test indicated that these variances were not statistically significant except for attitudes of farmers from Minnesota and California. At the 95-percent level of confidence, Minnesota farmers tended to be more restrictive and California farmers tended to be more liberal as to the circumstances under which a nonfamily farm corporation should be permitted to join a cooperative.

ADVANTAGES AND DISADVANTAGES OF NONFAMILY FARM CORPORATIONS BEING COOPERATIVE MEMBERS

Both advantages and disadvantages may accrue to family farmers, rural America, and consumers as a result of nonfamily farm corporations' participation in cooperatives. While we did not attempt to identify and quantify them fully because of the scarcity of objective data and the many ramifications of the economic and social issues involved, our consultants and others have identified some of the advantages and disadvantages of corporate involvement in cooperatives. Also, we observed one other potential disadvantage.

In our consultants' view, nonfamily farm corporations contribute management expertise and product volume to cooperatives which could benefit family farm members and consumers through increased efficiency, better coordination, and improved management. One cooperative manager indicated to us that the management expertise of nonfamily farm corporations was a plus to his cooperative. Another cooperative manager indicated that the added volume provided by nonfamily farm corporations should improve the operational effectiveness of cooperatives.

On the other hand, our consultants said that if corporations already enjoy advantages in agricultural production, their membership in cooperatives will likely increase those advantages and foster further corporate expansion in agriculture. The long-term effect of this could be to hasten the movement of family farmers out of agriculture, which is contrary to the Nation's policy to perpetuate the family farm system of agriculture. Moreover, it could jeopardize public confidence in cooperatives and the Capper-Volstead Act, which could lead to abolishing or seriously weakening family farmers' right to market products collectively. Our consultants also said that corporations have an incentive to become cooperative members because, unless they are operating on a very large scale, they can frequently market through cooperatives at a lower cost and at a higher price than they could on their own. As cooperative members, they frequently become prime prospects for membership on the cooperatives' boards of directors.

The Federal Trade Commission staff views corporate involvement in cooperatives as an opportunity for corporations to reduce competition in the marketing of agricultural products and escape antitrust liability. The Commission's September 1975 staff report on cooperatives (see p. 13) stated that there appear to be no advantages in allowing large agribusiness corporations to join cooperatives. If they want to sell through cooperatives, the report said, they may do so without being cooperative members through joint ventures, as long as competition is not unduly threatened. The report also indicated that allowing large corporations to attempt to eliminate competition among themselves through cooperative membership was contrary to the intent of the Capper-Volstead Act.

The disadvantage we observed is that some family farmers have probably been denied membership in cooperatives which were handling products for their nonfamily farm corporate members. During our review, we visited six cooperatives that had publicly held corporations as members. Three of the six cooperatives were not accepting all applications for membership at the time of our visit because of limitations on the total volume of member business they could or desired to handle. The corporate share of total business volume represented less than 1 percent in one cooperative and 3 to 5 percent in another cooperative. This data was not obtained for the third cooperative. We recognize that the volume of products handled for corporate members was relatively small, but the fact remains that without that volume, there would have been room in the cooperatives for other family farmers.

In summary, nonfamily farm corporations contribute management expertise and production volume to cooperatives which could help cooperatives to serve family farmer members better. However, their membership in cooperatives could (1) foster corporate expansion in agriculture, (2) hasten the movement of family farmers out of agriculture, (3) reduce competition in the marketing of agricultural products, and (4) keep family farmers from joining cooperatives.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress determine whether it is in the Nation's best interest to continue to allow nonfamily farm corporations to be members of cooperatives. If the Congress decides to limit participation of such corporations in cooperatives, the following ~~are~~ four options should be considered: and perceived consequences we developed with the help of our consultants.

--Ban corporate membership in cooperatives. This option would remove all potential problems associated with corporate membership in cooperatives noted above and should help maintain public confidence in cooperatives. But it would also eliminate any efficiencies and other benefits gained by cooperatives, family farmers, and consumers from corporate membership in cooperatives. If these were substantial, the total cost of marketing agricultural products could be increased.

--Limit corporate membership to a certain percent of the cooperative's volume of business or membership equities. This option would eliminate potential problems associated with the formation of cooperatives made up primarily or entirely of nonfamily farm corporations. It would also permit efficiencies and other benefits gained by cooperatives, family farmers, and consumers from corporate membership. This policy option would not, however, eliminate the potential problems discussed above, such as encouraging the expansion of corporations in farming, keeping family farmers out of cooperatives, and allowing corporations to reduce competition and escape antitrust liability.

--Ban corporate representation on cooperative boards of directors. This option would eliminate potential problems associated with the formation of cooperatives made up entirely of nonfamily farm corporations. Also, it would allow for economies resulting from corporate membership in cooperatives. It would not, however, eliminate or curtail the other potential problems discussed above, such as encouraging corporations to expand into farming thereby further threatening the position of the family farmer, keeping family farmers out of cooperatives, and allowing corporations to reduce competition and escape antitrust liability. Further, it could weaken the management expertise of cooperatives' boards of directors.

--Limit corporate membership to a certain percent of the cooperative's volume of business or membership equities and ban corporate representation on cooperatives' boards of directors. This option would eliminate the potential problem associated with the formation of cooperatives made up primarily or entirely of nonfamily farm corporations. Also, it would permit efficiencies and benefits gained from corporate membership in cooperatives. Further, it should alleviate potential problems, such as encouraging the expansion of corporations into farming, keeping family farmers out of cooperatives, and allowing corporations to reduce competition and escape antitrust liability. It would not, however, completely eliminate these potential problems.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Agriculture agreed with our treatment of the issue concerning corporate participation in cooperatives. (See app. VII.) It said that the four alternatives we presented to the Congress were well balanced but that the associated economic issues needed to be further researched before definitive recommendations are made to the Congress.

The Department of Justice said it shared the concern that large agribusiness corporations' using cooperatives could affect the viability of the family farm and the vigor of competition in the agricultural sector. (See app. IX.) It also said that before the question concerning corporate involvement in cooperatives could be adequately addressed, additional information needed to be developed, including (1) the identity and size of the corporations involved, (2) their degree of influence over cooperative activities and related markets, and (3) whether their cooperative status shields them from competition or enables them to engage in anticompetitive actions or agreements.

We recognize that the economic consequences, the anticompetitive effects, and other pertinent matters related to the question of whether to allow or not allow nonfamily farm corporations to participate in cooperatives may need to be more fully developed. The Congress could hold hearings and/or direct further work in the areas identified by Agriculture and Justice before it decides on the action to be taken.

CHAPTER 5

EQUITY REDEMPTION PRACTICES OF COOPERATIVES NEED TO BE IMPROVED

A key feature of cooperatives is that they operate at cost and distribute the net earnings or savings to member-patrons annually. For a cooperative to be exempted from paying income taxes, Federal tax law requires that at least 20 percent of the distributed net earnings be paid to member-patrons in cash. The remainder, up to 80 percent, which is distributed to member-patrons in the form of equity certificates, may be retained by the cooperative and used for such things as capital improvements, debt retirement, and operating expenses. Member-patrons, generally through acceptance of the cash portion, are obligated to pay Federal income taxes on the entire distribution.

The amount of earnings retained by cooperatives represents hundreds of millions of dollars. Many cooperatives have no plans for and/or have been slow in retiring the retained equities. This practice has discouraged some farmers from participating in or increasing their business with cooperatives. Moreover, much of the retained equity belongs to inactive and retired members or heirs of deceased members who do not benefit from the cooperatives' current operations.

A generally accepted cooperative principle is that its financing should be supported primarily by member-patrons currently using its services. To comply more fully with this principle, cooperatives need to adopt systematic programs to retire retained equity within a reasonable period of time.

EQUITY REDEMPTION PRACTICES OF COOPERATIVES ARE OF MAJOR CONCERN TO FARMERS

Each cooperative, usually through action by its board of directors, decides when and under what circumstances to retire retained equities. Some cooperatives have adopted systematic equity retirement programs and/or retire equities in a relatively short time. Others retire equities only under special circumstances, such as death, retirement, or hardship. Others have no program to retire retained equities and have not done so for many years or have never done so. Most cooperatives do not pay interest or dividends on retained equities.

Many farmers view the failure to retire retained equities in a timely manner as a major disincentive to participating in or increasing their business with cooperatives.

Also, former member-patrons view this practice as inequitable because they have money tied up in the cooperatives but do not benefit from cooperative activities and generally cannot vote on cooperative matters, including the election of boards of directors.

In the past, a number of former member-patrons of cooperatives without equity redemption programs have unsuccessfully sought help to change the practice of not retiring equities. Some have contacted their elected officials, both State and Federal, seeking assistance and urging possible legislative remedies. Others have sought relief in the courts only to learn that, generally, equity redemption is a discretionary matter falling within the fiduciary and trustee responsibilities of the cooperatives' boards of directors. However, a few States require or permit the redemption of member equities under certain circumstances, such as death, ineligibility, expulsion, and/or withdrawal of a member.

Bills have been introduced in the Congress to force cooperatives to retire retained equities. For example, a bill introduced in the 91st Congress (H.R. 13270) would have included a provision in the Revenue Act of 1969 to increase the cash portion of patronage refunds from 20 percent to 50 percent, phased over a 10-year period, and to require redemption of the noncash portion within 15 years from date of issuance. This provision was in the bill passed by the House of Representatives but was subsequently deleted by the Senate Finance Committee because of the unknown consequences.

Farmer Cooperative Service study

In an April 1977 report, 1/ the Department of Agriculture's former Farmer Cooperative Service 2/ reported that only 32 percent of its sample of 857 cooperatives carried out systematic programs for retiring retained equities. Another 39 percent had programs to retire equities under special circumstances, such as death, retirement, or hardship. The remaining 29 percent had no equity redemption programs.

1/"Equity Redemption Practices of Agricultural Cooperatives," FCS Research Report 41, Department of Agriculture, Apr. 1977.

2/This component was merged into the Economics, Statistics, and Cooperatives Service by Secretary's Memorandum No. 1927, Oct. 5, 1977.

The report stated that inactive cooperative members owned 32 percent of the equities retained by cooperatives without equity redemption programs and 22 percent of the retained equities held by cooperatives that had systematic or special redemption programs.

According to the report, the reasons the cooperatives cited for not retiring equities included (1) poor financial condition, (2) competitive reasons, (3) pressure from younger members to place a higher priority on cash distribution, (4) low priority on an equity redemption program, and (5) debt service requirements or restrictions placed on them by lending institutions. The primary factor influencing the presence or absence of any sort of equity redemption program was the amount of total assets. The more assets a cooperative had, the greater the probability of its carrying out a redemption program.

The study authors concluded that in many cases the cooperatives' reasons for not retiring equities had little merit and that practically all cooperatives could adopt some sort of program if they planned and budgeted for it. The report urged cooperatives to improve their equity retirement practices.

The head of the Cooperatives Unit said that the April 1977 report has given visibility to the equity redemption problem. He said also that he had used the report in speeches and in meetings with State cooperative councils to point out the need for cooperatives to retire retained equities.

Current conditions

As part of our review, we inquired about equity redemption practices of the cooperatives we visited. The results of our work generally supported the Farmer Cooperative Service's findings that many cooperatives have not voluntarily initiated action to retire systematically the retained equities of their members. The Service defined a systematic program for retiring equities as one that is carried out under a definite plan with a fair degree of regularity and where the fairly predictable financial requirements could be taken into account in a cooperative's financial budgeting process.

Of the 83 cooperatives we visited, 25 had systematic programs for retiring member equities; 38 had programs to retire equities under special circumstances, such as upon death or retirement; and 18 had no programs for equity retirement. Managers of the two remaining cooperatives did not know their cooperatives' policy.

According to the financial statements made available to us, 53 of the 56 cooperatives without systematic equity redemption programs had retained equities totaling over $750 million. Many of these cooperatives were holding equity that had been earned more than 15 years ago; some, over 30 years ago.

Farmer views

The questionnaire we sent to farmers included questions relating to retained equities and their use. (See app. II.) Over 65 percent of the responding farmers indicated that they would be encouraged to start or to increase their business with cooperatives if cooperatives did not wait so long to retire retained equities. Similarly, about 75 percent of the farmers indicated that they would be encouraged to start or increase their business with cooperatives if the cooperatives paid dividends or interest on retained equity. There was little difference between the responses from farmers who were or had been members of a cooperative and those who had not.

The majority of the farmers believed that, even at the expense of reducing cash refunds to current members, cooperatives should immediately retire a member's equity capital when the member moves out of the area, dies, or retires from farming. A lesser number thought that this should be done even when a member simply stops patronizing the cooperative for a given period of time. Farmers in all age groups were more strongly in favor of retiring the equity of deceased members than in any other circumstance.

ADVANTAGES AND DISADVANTAGES OF ALTERNATIVE WAYS TO IMPROVE EQUITY REDEMPTION PRACTICES

There are several ways in which the equity redemption practices of cooperatives could be improved. Each has certain advantages and disadvantages.

One alternative would be for Agriculture to make a concerted effort to encourage each cooperative to adopt a more favorable equity redemption program voluntarily. This alternative is preferred by Agriculture's Cooperatives Unit. Under this alternative, each cooperative would retain financial flexibility and control over its actions. The disadvantage, however, is that stiff competition would remain between (1) the cooperative's capital requirements and its desires to better serve current members and (2) the need to retire the equity of its inactive, retired, and deceased members. On the basis of decisions made by cooperatives in the past, measurable improvements under this alternative could be slow in developing.

Another alternative would be to enact legislation making it mandatory for cooperatives to pay interest or dividends on retained equities. This alternative could increase patronage in cooperatives and improve the viability of cooperatives as a competitive force in the marketplace. Also, it would compensate inactive and retired members and heirs of deceased members for use of their money and provide an economic incentive to cooperatives to retire equities on a more timely basis.

One cooperative we visited was issuing common stock for the value of retained equities and paying an 8-percent dividend on it annually. Each year the cooperative offers to retire a predetermined amount of its common stock. An official of the cooperative said that some members were holding stock issued over 30 years ago and that the cooperative had never been required to retire more stock than offered.

We recognize that requiring cooperatives to pay interest or dividends on retained equities would affect their cash flow positions. Therefore, if such requirements were imposed, they should be appropriately balanced between the need to provide each cooperative ample opportunity to plan and implement a systematic equity redemption program and the need for capital to finance cooperative operations and growth.

A third alternative would be to enact legislation making it mandatory for cooperatives to retire their retained equities within a certain time. Such a provision would no doubt shorten the time for retiring equity in many cooperatives. A shorter retirement period would result in more equitable treatment of current and former members and could reduce some of the negative feelings farmers have about cooperatives. Moreover, it could increase patronage in cooperatives and improve their viability as a competitive force in the marketplace. On the other hand, mandatory equity retirement requirements, if indiscriminately applied, would likely create financial hardships for many cooperatives and could even bankrupt some cooperatives. Moreover, such requirements may prevent cooperatives, especially those in their early years, from making capital improvements needed to serve their current members better.

A fourth alternative, combining the two discussed above, would be to enact legislation making it mandatory for cooperatives to (1) pay interest or dividends on retained equities and (2) return retained equities within a certain time. The advantages and disadvantages of this alternative would be similar to those discussed under the above two alternatives.

Any legislation should include a penalty that cooperatives that do not comply would lose their tax exemption status.

CONCLUSIONS

Many cooperatives are holding retained equities totaling hundreds of millions of dollars without adequate plans for returning those holdings. A large share of these equities belongs to former members. This practice is a major concern of cooperative members and nonmembers alike, and the cooperative movement in the United States has likely suffered as a result. Also, when retained equities are not retired or when they are retired slowly, a basic cooperative principle that financing be primarily the responsibility of current member-patrons is violated. It does not seem equitable for a cooperative to use indefinitely money belonging to its inactive and retired members and heirs of deceased members without a program to retire those holdings or pay interest for their use.

Although a few States require or permit cooperatives to retire the retained equities of former members under certain circumstances, the decision to keep or retire retained equities has generally been left to each cooperative. Experience has shown that many cooperatives have not been motivated to make the financial adjustments necessary to retire retained equities in a timely and equitable manner. Therefore, either Agriculture needs to intensify its efforts to motivate cooperatives to improve their equity redemption practices, or the Congress needs to enact legislation forcing cooperatives to do so.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that the Secretary direct the Cooperatives Unit to conduct, jointly with the Extension component of the Department's Science and Education Administration, a national campaign to motivate cooperatives to adopt voluntarily equity redemption programs that are fair to both current and former members. We recommend further that if cooperatives are not willing to adopt more equitable equity redemption programs voluntarily, the Secretary develop a legislative proposal to make it mandatory for cooperatives to

--pay interest or dividends on retained equities,

--retire retained equities within a certain time, or

--pay interest or dividends on retained equities and retire retained equities within a certain time.

The legislation should include a clause that cooperatives that do not comply with the requirements would lose their tax exemption status. The advantages and disadvantages of each of these alternatives are discussed on pages 42 and 43.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Agriculture concurred in our recommendation that a national campaign be conducted to motivate cooperatives to adopt more favorable equity redemption programs voluntarily. It disagreed, however, that if this campaign failed, the Secretary should develop a legislative proposal making payments on certain equities mandatory. (See app. VII.) It agreed that cooperatives need to systematize their equity redemption programs but said that legislative action is unwarranted. It also said that cooperative members make the decision to invest their earnings in cooperatives through their elected boards of directors. One of our consultants agreed with Agriculture's positions.

We recognize that cooperative members may collectively have the power to force their cooperatives to improve equity redemption programs through the election of boards of directors. For reasons unknown to us, however, cooperative members have not exercised this power in many cooperatives. As a result, a large part of retained equities held by cooperatives belongs to inactive and retired members or heirs of deceased members who do not benefit from the cooperatives' current operations. Generally, these persons are not allowed to vote on cooperative matters, including the election of boards of directors.

The majority of the farmers who responded to our questionnaire said that cooperatives should immediately retire a member's equity, even at the expense of reducing cash refunds to current patrons, when the member dies, retires, or moves. Moreover, the majority of those farmers said that they would be encouraged to start or increase their business with cooperatives if cooperatives did not wait so long to retire retained equities. Because of these factors, we believe that legislation is warranted if cooperatives do not respond to Agriculture's efforts to motivate them to adopt more favorable programs voluntarily.

Regarding our legislative alternatives, Agriculture said that the proposal to make it mandatory for cooperatives to retire retained equities within a certain time would erode cooperatives' equity positions and could lead to their financial ruin because retained equities would become debt obligations to cooperatives. Also, it said that if retained equities were classified as security instruments, the

Securities and Exchange Commission may require them to be registered, thereby causing an additional financial burden on cooperatives.

We have recognized that both benefits and liabilities would result if this legislative proposal were enacted into law. We would expect Agriculture to make a comprehensive economic analysis before it makes a legislative proposal to solve the equity redemption problem.

Agriculture said that the proposal to require cooperatives to pay interest on retained equities amounts simply to an internal accounting transfer of money from net savings to returns to capital. It also said that cooperatives historically have followed a practice of making capital subservient to use of the organizations and to require cooperatives to pay interest on retained equities would alter that practice.

In our opinion, this practice should be altered because it has resulted in inequitable treatment of former members who have money invested in cooperatives but no longer have use for their services. Requiring cooperatives to pay interest on retained equities would result in more than an internal accounting transfer of money. It would compensate current and former members for the use of their money, which now is usually not the case. Moreover, it could provide an economic incentive for cooperatives to retire equities on a more timely basis.

The Department of Justice said that we have implied that cooperatives have large amounts of cash or other liquid assets readily available to retire retained equities. (See app. IX.) It said that it had received unsubstantiated reports that some cooperatives have used members' equities in fixed plants and equipment or to cover operating expenses. It concluded that, if these kinds of situations were widespread, any legislative effort to improve equity redemption programs could be seriously hampered.

We have not said that cooperatives have large amounts of cash and other liquid assets readily available to retire retained equities. For that matter, we recognized that mandatory provisions forcing retirement of retained equities could create financial hardships for many cooperatives and could even bankrupt some. (See p. 43.) However, as pointed out on page 41, the authors of a Department of Agriculture study of the equity redemption practices of agricultural cooperatives concluded that practically all cooperatives could adopt some sort of equity redemption program if they were determined to plan and budget for it.

CHAPTER 6

EVALUATION OF TECHNICAL AND EDUCATIONAL

ASSISTANCE TO COOPERATIVES

Since the early days of the cooperative movement in the United States, the Federal Government's policy has been to provide technical and educational assistance to agricultural cooperatives. Legislative authority for Federal support and assistance to cooperatives was provided in the Cooperative Marketing Act of 1926. This act directed the Secretary of Agriculture to create a division of cooperative marketing to render service to associations of agricultural producers engaged in the cooperative marketing of agricultural products, including processing, warehousing, manufacturing, and storage; the cooperative purchasing of farm supplies, credit, financing, and insurance; and other cooperative activities. The act authorized the division to

--acquire, analyze, and disseminate information pertaining to cooperatives;

--confer with and advise producers interested in forming a cooperative association; and

--promote the knowledge of cooperative principles and practices.

Two Department of Agriculture agencies share most of the responsibility for providing direction and assistance to farmers in organizing, formulating, and operating farmer cooperatives. The Cooperatives Unit of the Economics, Statistics, and Cooperatives Service, has primary responsibility for this work. It conducts research, provides technical assistance, encourages cooperative development, and maintains historical and statistical information on cooperatives. It has a staff of about 80 people headquartered in Washington, D.C., and 2 people located in field offices--one in North Carolina and one in California.

The other agency is the Extension component of the Science and Education Administration. This agency has one full-time staff member at the headquarters level assigned to work with State extension organizations for developing educational programs for cooperatives. Extension is affiliated with land-grant universities and local governments which have specialists, as well as area staffs and county agents located in nearly every county throughout the United States, to help individuals, families, and groups apply the newest proven technology and management techniques to the everyday problems of living and making a living. Most land-grant universities have at least one specialist to deal with cooperative matters.

We interviewed cooperative and other officials knowledgeable about cooperatives in eight States to

--determine whether adequate technical and educational assistance services for cooperatives were available and

--if not, obtain views on what steps the Federal Government should take to improve service programs to satisfy unmet needs.

According to the interviewees, the technical and educational assistance needs of established cooperatives were generally being met by existing sources. Principal sources included the Cooperatives Unit, extension organizations, regional cooperatives, State departments of agriculture, and banks for cooperatives. Cooperative officials expressed general satisfaction with the quality of services available and perceived no significant need for additional Federal assistance programs for established cooperatives.

We noted, however, that the Cooperatives Unit had developed plans to set up additional field offices to assist new and developing cooperatives without coordinating those plans with Extension to avoid possible duplication of effort and to increase efficiency of Government programs.

EXAMPLES OF TECHNICAL AND EDUCATIONAL ASSISTANCE AVAILABLE TO COOPERATIVES

The Federal, State, and private programs to provide technical and educational assistance to cooperatives are reasonably extensive. The following are examples of such activities in some of the States we visited.

Agriculture's Cooperatives Unit, jointly with Extension and/or others, studied the feasibility of (1) establishing a vegetable marketing cooperative in North Carolina (1978), (2) establishing a tomato marketing cooperative in Alabama (1978), (3) improving cooperative marketing of slaughter cows and calves in the Northeast (1977), and (4) processing off-grade apples in Missouri (1979).

The extension service at North Carolina State University and the North Carolina Cooperative Council jointly sponsor educational workshops and youth activities concerned with cooperatives. For example, an "Institute for Cooperatives" is held annually which consists of meetings held across the State for cooperative managers and boards of directors.

The North Carolina Department of Agriculture provides assistance both to farmers wanting to organize cooperatives and to existing cooperatives. It conducts feasibility studies on proposed cooperatives to determine if cooperatives could be successful and helps prepare the articles of incorporation and bylaws, including matters relating to membership, boards of directors, officers, and distribution of earnings. The State Cooperative Services Section provides the following services to existing cooperatives:

--Confers with management and members on how to improve or expand their services.

--Advises and assists in planning physical expansion.

--Advises and assists in obtaining financial assistance.

--Reviews operational procedures and recommends changes for greater efficiency.

--Assists management and member relations staff workers in maintaining the proper image among the general public.

Cooperatives in Virginia receive assistance primarily through extension service programs at the Virginia Polytechnic Institute and State University (VPI). The Virginia Department of Agriculture and the Virginia Council of Farmer Cooperatives also provide assistance.

The VPI extension service has one person assigned to work primarily with cooperatives, although practically everyone on the staff reportedly has worked with them at some time. VPI conducts educational meetings with groups interested in establishing cooperatives and, in some cases, performs feasibility studies. Each year VPI receives from four to seven requests from groups wanting to form a cooperative.

For most of the past 12 to 14 years, VPI, in cooperation with the Virginia Council of Farmer Cooperatives, has sponsored training programs for boards of directors. These are 1-day programs held four or five times a year in different areas of the State. Along with the Baltimore Bank for Cooperatives, the Cooperatives Unit, the American Institute of Cooperation, and others, VPI has recently begun sponsoring regional workshops for cooperative leaders. It also conducts week-long training sessions for cooperative managers and assists cooperatives on a one-to-one basis. For example, it conducted a review of one cooperative to identify management problems.

The Kansas State University offers a cooperative research course entitled "Bargaining and Cooperation in Agriculture." The university has allocated 1 staff-year to assist cooperatives with various agricultural problems and questions, including cooperative management. The university recently completed a study analyzing the grain distribution system for a large regional marketing cooperative. The cooperative had requested the university's assistance and agreed to pay the study cost. Also, officials at the Wichita Bank for Cooperatives said Kansas local cooperatives were assisted by the regional cooperatives with which they are affiliated. The bank has also provided assistance in financial management and made feasibility studies for cooperatives wanting to expand their operations.

Managers of the six local cooperatives we visited in Kansas said that their regional cooperative provided assistance in managerial training, marketing, merchandising, and grain grading and blending. Additionally, the Kansas Farmers Service Association, a service cooperative owned by Kansas cooperatives, provided accounting, legal, and insurance services.

The University of Minnesota extension service responds to specific requests from cooperatives for assistance. It also conducts workshops periodically for cooperative management. About 500 cooperative directors attend those workshops each year. Also, the St. Paul Bank for Cooperatives provides assistance on financial matters, including long-range planning and feasibility studies.

The University of Wisconsin's Center for Cooperatives has a number of service programs available to cooperatives. Most of these programs are cosponsored by the St. Paul Bank for Cooperatives, the Wisconsin Federation of Cooperatives, and some regional cooperatives. The center concentrates on teaching general subjects that all cooperative directors and managers should know. These include principles of management, legal liabilities of directors, and how to conduct meetings. The center also assists new cooperatives establish operations.

Other sources of assistance for local cooperatives in both Minnesota and Wisconsin are the regional cooperatives with which many local cooperatives are affiliated. These regional cooperatives provide such services as

--assisting member cooperatives in obtaining financing;

--sponsoring clinics and workshops for cooperative managers, directors, and farmers;

--providing marketing services;

--providing management development schools for cooperative managers and employees; and

--providing advice on articles of incorporation and bylaws.

The University of Missouri extension service has had several programs directed toward assisting Missouri cooperatives. According to a 1976 university report, educational programs are provided for members and leaders of agricultural cooperatives, and during October 1975, the month designated as "cooperation month," regional training conferences for cooperative leaders were held in four areas of the State.

In its 1977 report on agricultural extension programs, the university listed, among others, education programs on business management and economics, agricultural and farm supply marketing, and leadership development. A university official said that, although these programs were not specifically directed toward cooperatives, many cooperative managers and directors attended them.

QUALITY OF AVAILABLE TECHNICAL AND EDUCATIONAL ASSISTANCE

Cooperative officials we interviewed were generally satisfied with the quality of services available from the Federal agencies, State agencies, regional cooperatives, and banks for cooperatives. They perceived no significant need for the Federal Government to expand programs for providing technical and educational assistance to existing cooperatives. Examples of comments we received are as follows:

--The president of a major regional cooperative in the Midwest told us that it found information published by the Cooperatives Unit very helpful in its self-evaluations of how it can best serve farmers.

--The manager of a major regional supply cooperative said that research and technical studies performed over the years by the Cooperatives Unit have been of immeasurable value to cooperatives and their growth within agriculture.

--The manager of a major regional cooperative in North Carolina said that the assistance provided by the university, the North Carolina Department of Agriculture, and the Cooperatives Unit was adequate. He added that he knew nothing more the agencies could do for the cooperative.

--The manager of a local supply cooperative in Minnesota said that he was very satisfied with the service received from the University of Minnesota. He also said that he received satisfactory assistance from the major regional cooperative with which the local cooperative is affiliated.

--The manager of a cooperative in Kansas said that the Cooperatives Unit's reports were useful and the cooperative had implemented some recommendations. The manager also said that the regional cooperative with which his cooperative was affiliated provided satisfactory assistance.

--The manager of a local cooperative elevator in Kansas said that a major regional cooperative and Kansas State University had provided adequate assistance. He said, for example, that the regional cooperative made a feasibility study on expansion of grain storage facilities at no cost to the local cooperative. Also, the regional cooperative sometime ago had prepared a long-range growth plan which was used as a basis for the local cooperative's recent expansion.

--The manager of a local elevator and supply cooperative in Kansas said that the major regional cooperatives, the Bank for Cooperatives, and the Farmers Service Association provided all necessary assistance. The assistance has been excellent. He added that employees of his cooperative frequently attend training courses and seminars conducted by those organizations.

PROGRAM PLANNED FOR COOPERATIVE DEVELOPMENT NEEDS TO BE COORDINATED

The Cooperatives Unit plans to expand its efforts to assist in the organization and development of new and developing cooperatives. As part of this effort, it plans to establish additional field offices. It had not, however, coordinated these field office plans with the Science and Education Administration's Extension component or with State extension officials. Such coordination is necessary to avoid possible duplication of effort and to increase the efficiency of Government programs.

Cooperative development is an increasingly important activity of the Cooperatives Unit, and an important aspect of this work is helping low-resource and minority groups. This effort appears to be in line with the farmers' views expressed at five regional small farm conferences cosponsored by the Department of Agriculture, the Community Services Administration, and ACTION during 1978. A December 1978 summary report on these conferences stated that many of the delegates indicated that they lacked alternative markets and needed help in developing new marketing outlets, including the development of cooperatives. In addition, the majority of the farmers who responded to our questionnaire indicated that they would be encouraged to start or increase their business with cooperatives if cooperatives were available or more conveniently located. (See app. II.)

As of May 1977 the Cooperatives Unit had about 6 staff-years committed to cooperative development activity, and in its fiscal year 1979 budget submission, it recommended that this effort be increased to about 29 staff-years. Although the fiscal year 1979 budget submission was not approved, the Unit's head expanded the cooperative development program to about 14 staff-years by redirecting existing resources. Moreover, in addition to the two field offices it now operates, the Unit plans to establish another one in fiscal year 1979 and four more in fiscal year 1980 to work with new and developing cooperatives. Locations being considered for these offices are north-central Alabama, Maine, Arkansas, Hawaii, Puerto Rico, and the lower Rio Grande area of Texas.

Each field office is or will be staffed by one person to work with cooperatives as needed on:

--Organizational problems.

--Economic feasibility of the cooperative enterprise.

--The financial package needed for appropriate consideration by potential lenders.

--Articles of incorporation, bylaws, and various contractual arrangements.

--Coordination of all interested Federal, State, and county agencies that have an input into cooperative development.

--Continuing guidance to members, boards of directors, and managers, particularly as major or strategic decisions are being considered.

The Cooperatives Unit indicated that the need to establish a field office in Alabama was the most urgent. It had been working with one broiler cooperative for some time and stated that there were at least three other groups that would need feasibility studies in the near future. We discussed the Unit's plans for establishing a field office in Alabama with Auburn University officials. They had not been aware of those plans. They said that the Cooperatives Unit should contact them before a field office is established because the university has the expertise and experience for organizing cooperatives.

Moreover, according to an official in the Science and Education Administration's Extension component, the Cooperatives Unit had not discussed its plans to establish field offices with Extension. He was surprised that Puerto Rico was one of the locations being considered. He said that Puerto Rico had a Cooperative Development Administration with between 300 and 400 employees to assist with cooperative development.

CONCLUSIONS

Technical and educational assistance programs administered by the Cooperatives Unit, Federal and State extension organizations, regional cooperatives, State departments of agriculture, and others appeared adequate to satisfy the technical assistance needs of established cooperatives.

The Cooperatives Unit has increased its emphasis on assisting new and developing cooperatives, particularly those involving low-resource and minority groups. This increased emphasis includes plans to establish additional field offices at selected locations.

To avoid duplication and to increase the efficiency of Government assistance programs to cooperatives, the Cooperatives Unit should coordinate its plans for delivering technical assistance to new and developing cooperatives with the Extension component of the Science and Education Administration and its affiliated extension agencies. With its network of land-grant universities and county extension offices, Extension has had much experience working with farmers and cooperatives at the local level and may be able to assist the Cooperatives Unit in carrying out cooperative development programs in those areas where additional cooperatives could serve a useful function in assisting family farmers.

RECOMMENDATION TO THE SECRETARY OF AGRICULTURE

We recommend that the Secretary of Agriculture require the Cooperatives Unit to coordinate fully its plans for assisting new and developing cooperatives with the Extension component of the Science and Education Administration and its affiliated extension agencies before additional field offices are established.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Agriculture said that the Cooperatives Unit's plans for new field offices would have the support of the Science and Education Administration's Extension component and other appropriate Federal and State agencies and organizations before additional field offices were established. (See app. VII.) It said, however, that the inference that the Cooperatives Unit's field offices had been established or even planned without close coordination and support of the concerned State extension service was unfounded. It said that the Unit's two existing field offices have had the support of the State extension service where they are located and of other State agencies, and it indicated that the Unit's plans for additional field offices had not progressed beyond internal preliminary budget planning involving discussion of their possible establishment.

We did not say or imply that the Unit's existing field offices had been established without coordination with the concerned State extension service. It was apparent, however, that planning for the additional field offices had progressed much further than Agriculture indicated and that these plans had not been coordinated with other appropriate agencies. In its fiscal year 1980 budget submission, Agriculture told the Congress that one additional field office would be established in fiscal year 1979 and four more would be established in fiscal year 1980 to assist in the development of new cooperatives for low-resource farmers. According to an Extension official and Auburn University officials, this action was planned without any input from the Extension component or its affiliated extension agencies. (See p. 54.)

Agriculture made several additional comments about our evaluation of technical assistance to cooperatives which require clarification. It said that in the report the concept of providing cooperative educational information and technical assistance was intertwined and confused, and that a difference of opinion existed between Agriculture and GAO as to what constitutes "technical" as distinct from "educational" assistance.

Agriculture said that technical assistance is designed specifically to benefit a requesting group or cooperative. It indicated that educational assistance was more general, consisting of materials and training sessions on such cooperative-related areas as the role and responsibility of cooperative directors and improving the overall management and performance of cooperative management and employees. For the purpose of our review, we viewed technical assistance as all forms of assistance to cooperatives, including specific requests as well as the more general educational assistance. We have made certain revisions in the report to make it clear that we are talking about both technical and educational assistance.

Also, Agriculture questioned the validity of our statement that technical assistance needs of established cooperatives were generally being met by sources currently available. However, it offered no evidence to the contrary. It simply restated the objection to our broader interpretation of technical assistance, reiterated Extension's role in providing educational assistance, and cited technical assistance work of the Cooperatives Unit in the States we visited.

Our statement is based primarily on interviews with cooperative and other officials knowledgeable about cooperatives in the eight States we visited. As the report points out, the officials were generally satisfied with the quality of available services and perceived no significant need for additional Federal assistance programs for established cooperatives.

BACKGROUND INFORMATION ON

CONSULTANTS USED IN THIS REVIEW

Ronald D. Knutson

Dr. Knutson is a professor in the Department of Agricultural Economics, Texas A & M University. He is responsible for teaching, research, and extension programs in the areas of food policy and marketing. He was employed by the Department of Agriculture from September 1971 to August 1975, first as a staff economist, Agricultural Marketing Service, and later as the Administrator, Farmer Cooperative Service. He has served as a consultant to cooperatives, corporations, and a State Government; testified as an expert witness in several antitrust proceedings; and participated in several projects, including the National Academy of Science's world food and nutrition study (1976), Texas A & M University's study of marketing alternatives for producers (1978), and the President's reorganization project for agriculture (1978-79).

Dr. Knutson is the author of chapters in 5 books and the author or coauthor of 9 research reports, 17 journal articles, and 36 popular articles dealing with a wide variety of agricultural and/or cooperative issues, problems, and needs. He was listed in "Who's Who in Government," 1975-76; "Who's Who in American Politics," 1975-79; and "Who's Who in America," 1976-79. He is a member of the following professional societies:

--American Agricultural Economics Association.

--Food Distribution Research Society.

--Omicron Delta Epsilon (an honorary economics society).

--Gamma Sigma Delta (an honorary agricultural society).

--Phi Tau Sigma (an honorary food science society).

--Sigma Xi (an honorary science society).

Leon Garoyan

Dr. Garoyan is an agricultural economist at the University of California. His duties and responsibilities include analyzing economic problems in agribusiness and determining alternative solutions, assisting agribusiness firms in planning, maintaining liaison between industry and Government, and teaching courses in agricultural marketing and business management. He served as a staff economist, Office of the Secretary, Department of Agriculture, from 1963 to 1964. He has served as a consultant to the Federal Trade Commission and the Department of Justice on antitrust matters and to the President's reorganization project for agriculture.

Dr. Garoyan is the author or coauthor of 6 books and over 100 research reports or articles dealing with a wide variety of agricultural and/or cooperative issues, problems, and needs. He received a distinguished service citation for research from the Association for Cooperative Education in 1971 and a research award from the National Planning Committee for Cooperatives in 1973. He is a member of the American Agricultural Economics Association, the Western Agricultural Economics Association, the Commonwealth Club of California, and the American Men of Science.

RESULTS OF QUESTIONNAIRE TO FARMERS

To determine how farmers view cooperatives, we solicited responses through a mailed questionnaire to a random sample of farmers in 12 States representing each region of the United States. The total sample size was 672 farmers allocated to each State in proportion to that State's farm population. The Department of Agriculture's Statistics Unit selected the sample for us from its general inventory of farmers.

We received responses from 487, or about 72 percent, of the 672 farmers. For many responses, however, one or more of the questions were not answered. The farmers responding (1) ranged in age from under 25 years to over 65 years, (2) had gross farm sales ranging from under $10,000 to over $1 million annually, and (3) were involved in all major types of farming enterprises. Also, about 67 percent had been or were cooperative members; about 33 percent were not. Following is a summary of the farmers' responses to certain cooperative issues.

IMPORTANCE OF COOPERATIVES TO FAMILY FARMERS

Following are farmers' responses to selected questions we asked to obtain an overall view of the importance of cooperatives to family farmers.

--To what extent have cooperatives promoted a better way of living for family farmers?

Questionnaire choices	Responses Number	Responses Percent
1. Very great extent	43	12.9
2. Substantial extent	87	26.0
3. Moderate extent	84	25.1
4. Some extent	68	20.4
5. Little or no extent	52	15.6
Total	334	100.0

--To what extent have cooperatives increased the income of the family farmer?

Questionnaire choices	Responses Number	Percent
1. Very great extent	35	10.6
2. Substantial extent	70	21.1
3. Moderate extent	108	32.6
4. Some extent	63	19.0
5. Little or no extent	55	16.6
Total	331	a/100.0

--Consider how cooperatives serve the small and large farmers. (Large farmer means $40,000 and greater in annual farm sales.)

Questionnaire choices	Responses Number	Percent
1. Cooperatives serve small farmers greatly at the expense of large farmers	8	1.9
2. Cooperatives serve small farmers somewhat at the expense of large farmers	24	5.7
3. Cooperatives serve both types of farmers at the expense of neither	255	60.4
4. Cooperatives serve large farmers somewhat at the expense of small farmers	61	14.5
5. Cooperatives serve large farmers greatly at the expense of small farmers	32	7.6
6. Cooperatives serve neither small nor large farmers	42	10.0
Total	422	a/100.0

a/ Does not add due to rounding.

--To what extent do family farmers need marketing cooperatives in order to remain in farming?

Questionnaire choices	Responses Number	Responses Percent
1. Very great extent	131	34.3
2. Substantial extent	106	27.7
3. Moderate extent	66	17.3
4. Some extent	34	8.9
5. Little or no extent	45	11.8
Total	382	100.0

SHOULD NONFAMILY FARM CORPORATIONS BE PERMITTED TO JOIN COOPERATIVES?

The farmers who responded had mixed views on this question. Their responses were are follows:

Questionnaire choices	Responses Number	Responses Percent
1. Under no circumstances	127	30.4
2. Only if its gross sales are less than $100,000	29	6.9
3. Only if its gross sales are less than $500,000	24	5.7
4. Only if its gross sales are less than $1 million	6	1.4
5. Always, regardless of the amount of gross farm sales	232	55.5
Total	418	a/100.0

COOPERATIVES' RETAINED EQUITY POLICY

Following are responses to selected questions we asked to obtain the farmers' views on cooperative policies regarding retained equities.

--To what extent do cooperatives retain more equity than is needed to carry out their business?

a/ Does not add due to rounding.

Questionnaire choices	Responses Number	Percent
1. Very great extent	29	7.1
2. Substantial extent	51	12.4
3. Moderate extent	104	25.3
4. Some extent	122	29.7
5. Little or no extent	104	25.3
Total	410	a/100.0

--To what extent is the equity retained by the cooperative wisely invested?

Questionnaire choices	Responses Number	Percent
1. Very great extent	53	12.7
2. Substantial extent	86	20.6
3. Moderate extent	94	22.5
4. Some extent	65	15.6
5. Little or no extent	20	4.8
6. No personal knowledge	100	23.9
Total	418	a/100.0

--To what extent should cooperatives do each of the following, even at the expense of reducing cash funds to current patrons?

A. Immediately retire equity capital of a member moving out of the area.

Questionnaire choices	Responses Number	Percent
1. Very great extent	93	24.2
2. Substantial extent	55	14.3
3. Moderate extent	81	21.0
4. Some extent	76	19.7
5. Little or no extent	80	20.8
Total	385	100.0

a/ Does not add due to rounding.

B. Immediately retire equity capital of a deceased member.

Questionnaire choices	Responses Number	Percent
1. Very great extent	191	49.1
2. Substantial extent	68	17.5
3. Moderate extent	45	11.6
4. Some extent	38	9.8
5. Little or no extent	47	12.1
Total	389	a/100.0

C. Immediately retire equity capital of a member who simply stops patronizing the cooperative for a given period of time.

Questionnaire choices	Responses Number	Percent
1. Very great extent	52	13.6
2. Substantial extent	35	9.2
3. Moderate extent	63	16.5
4. Some extent	78	20.4
5. Little or no extent	154	40.3
Total	382	100.0

D. Immediately retire equity of a member who retires from farming.

Questionnaire choices	Responses Number	Percent
1. Very great extent	111	28.8
2. Substantial extent	54	14.0
3. Moderate extent	74	19.2
4. Some extent	73	18.9
5. Little or no extent	74	19.2
Total	386	a/100.0

--To what extent would each of the following encourage you to (1) begin marketing or market more of your products and (2) begin buying or buy more of your supplies and equipment through a cooperative?

a/ Does not add due to rounding.

A. Cooperatives did not wait so long to retire retained equities.

Questionnaire choices	Responses: Marketing Number	Marketing Percent	Buying Number	Buying Percent
1. Very great extent	37	10.1	41	11.0
2. Substantial extent	49	13.3	47	12.6
3. Moderate extent	76	20.7	75	20.1
4. Some extent	103	28.0	83	22.2
5. Little or no extent	103	28.0	128	34.2
Total	368	a/100.0	374	a/100.0

B. Cooperatives gave higher interest or dividends on retained equity or equity capital.

Questionnaire choices	Responses: Marketing Number	Marketing Percent	Buying Number	Buying Percent
1. Very great extent	68	18.1	73	19.8
2. Substantial extent	70	18.6	59	16.0
3. Moderate extent	70	18.6	61	16.6
4. Some extent	79	21.0	81	22.0
5. Little or no extent	89	23.7	94	25.5
Total	376	100.0	368	a/100.0

CONVENIENCE OF COOPERATIVES

To measure the extent to which cooperatives were available to serve farmers, we asked the following question.

--To what extent would you (1) begin marketing or market more of your products and (2) begin buying or buy more of your supplies and equipment through a cooperative if it were available or more conveniently located?

a/ Does not add due to rounding.

Questionnaire choices	Responses			
	Marketing		Buying	
	Number	Percent	Number	Percent
1. Very great extent	88	22.6	90	23.1
2. Substantial extent	68	17.4	72	18.5
3. Moderate extent	66	16.9	70	18.0
4. Some extent	73	18.7	66	17.0
5. Little or no extent	95	24.4	91	23.4
Total	390	100.0	389	100.0

CHANGES IN FARM NUMBERS AND GROSS FARM INCOME

FROM 1960 THROUGH 1977 (note a)

Gross annual sales	Farms 1960 Number	Farms 1960 Percent of total	Farms 1977 Number	Farms 1977 Percent of total	Gross farm income (note b) 1960 Amount	Gross farm income (note b) 1960 Percent of total	Gross farm income (note b) 1977 Amount	Gross farm income (note b) 1977 Percent of total
					(000,000 omitted)		(000,000 omitted)	
$100,000 and over	23,000	.6	162,000	6.0	$ 6,101	17.3	$52,224	52.6
40,000 to 99,999	90,000	2.3	348,000	12.9	5,457	15.5	25,469	25.6
20,000 to 39,999	227,000	5.7	321,000	11.9	6,518	18.5	11,089	11.1
10,000 to 19,999	497,000	12.5	311,000	11.5	7,438	21.1	5,409	5.4
5,000 to 9,999	660,000	16.7	302,000	11.2	5,160	14.7	2,697	2.7
2,500 to 4,999	617,000	15.6	304,000	11.2	2,478	7.1	1,351	1.4
Under 2,500	1,849,000	46.6	958,000	35.3	2,042	5.8	1,211	1.2
	3,963,000	100.0	2,706,000	100.0	$35,194	100.0	$99,450	100.0

a/Estimated on the basis of data from the Census of Agriculture, periodic surveys, and special studies.

b/Includes cash receipts from farm marketings, Government payments, and other farm-related income.

Source: Economics, Statistics, and Cooperatives Service, Department of Agriculture.

PERCENTAGE OF AGRICULTURAL PRODUCTION

VERTICALLY COORDINATED IN 1960 AND 1970 (note a)

	1960			1970		
	Production contracts	Vertical integration	Total	Production contracts	Vertical integration	Total
Crops:						
Feed grains	.1	.4	.5	.1	.5	.6
Hay and forage	.3	-	.3	.3	-	.3
Food grains	1.0	.3	1.3	2.0	.5	2.5
Vegetables for fresh market	20.0	25.0	45.0	21.0	30.0	51.0
Vegetables for processing	67.0	8.0	75.0	85.0	10.0	95.0
Dry beans and peas	35.0	1.0	36.0	1.0	1.0	2.0
Potatoes	40.0	30.0	70.0	45.0	25.0	70.0
Citrus fruits	60.0	20.0	80.0	55.0	30.0	85.0
Other fruits and nuts	20.0	15.0	35.0	20.0	20.0	40.0
Sugarbeets	98.0	2.0	100.0	98.0	2.0	100.0
Sugar cane	40.0	60.0	100.0	40.0	60.0	100.0
Other sugar crops	5.0	2.0	7.0	5.0	2.0	7.0
Cotton	5.0	3.0	8.0	11.0	1.0	12.0
Tobacco	2.0	2.0	4.0	2.0	2.0	4.0
Oil-bearing crops	1.0	.4	1.4	1.0	.5	1.5
Seed crops	80.0	.3	80.3	80.0	.5	80.5
Miscellaneous crops	5.0	1.0	6.0	5.0	1.0	6.0
Total crops	8.6	4.3	12.9	9.5	4.8	14.3
Livestock:						
Fed cattle	10.0	3.0	13.0	18.0	4.0	22.0
Sheep and lambs	2.0	2.0	4.0	7.0	3.0	10.0
Hogs	.7	.7	1.4	1.0	1.0	2.0
Fluid-grade milk	95.0	3.0	98.0	95.0	3.0	98.0
Manufacturing-grade milk	25.0	2.0	27.0	25.0	1.0	26.0
Eggs	5.0	10.0	15.0	20.0	20.0	40.0
Broilers	93.0	5.0	98.0	90.0	7.0	97.0
Turkeys	30.0	4.0	34.0	42.0	12.0	54.0
Miscellaneous livestock	3.0	1.0	4.0	3.0	1.0	4.0
Total livestock	27.2	3.2	30.4	31.4	4.8	36.2
Total crops and livestock	15.1	3.9	19.0	17.2	4.8	22.0

a/Estimates based on judgments of Department production and marketing specialists.

Source: Department of Agriculture, Economic Research Service (now a component of the Economics, Statistics, and Cooperatives Service), ERS-479, Apr. 1972.

COOPERATIVES' SHARE OF AGRICULTURAL PRODUCTS MARKETED FOR CROP YEAR 1975-76

Commodity	Cooperatives' share
	(percent)
Grain and soybeans	40.2
Rice	54.2
Dry beans and peas	28.4
Cotton and cottonseed	26.2
Tobacco	12.9
Fruits and vegetables	25.9
Peanuts and tree nuts	43.2
Sugar crops	57.2
Dairy products	68.4
Livestock products	9.6
Wool and mohair	24.3
Poultry and eggs	8.3
Other commodities	12.6
Total	28.6

Source: Cooperatives Unit, Economics, Statistics, and Cooperatives Service, Department of Agriculture.

COOPERATIVES' SHARE OF FARM SUPPLY

ITEMS SOLD FOR CROP YEAR 1975-76 (note a)

Item	Cooperatives' share
	(percent)
Feed	18.6
Seed	15.4
Fertilizers and lime	35.9
Pesticides	33.3
Petroleum products	28.1
Building materials; irrigation and drainage equipment	6.2
Farm machinery and equipment; motor vehicles; parts and accessories	2.5
Total	18.1

a/ Preliminary.

Source: Cooperatives Unit, Economics, Statistics, and Cooperatives Service, Department of Agriculture.

U.S. DEPARTMENT OF AGRICULTURE
ECONOMICS, STATISTICS, and COOPERATIVES SERVICE
WASHINGTON, D.C. 20250

April 30, 1979

Mr. Henry Eschwege, Director
Community and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

The report "Family Farmers Need Cooperatives--But Some Issues Need to be Resolved" has been reviewed within ESCS, the Agricultural Marketing Service, and the Science and Education Administration. We feel the report adequately details the economic environment in which today's family farmers operate and the role cooperatives play in servicing their economic and other needs. Also, the report points out several important issues facing cooperatives in the increasingly complex environment in which they must operate. We do, however, have reservations about several of the suggestions and recommendations in the report.

First, those areas in which we agree.

We agree with the way the report develops the issues associated with non-family farm corporate membership in cooperatives and the four alternative recommendations to Congress. The treatment is balanced. We do think there is a need for additional research on the economic issues associated with corporate membership in cooperatives that should precede definitive recommendations to Congress.

We also concur in the recommendation to the Secretary requiring the Office for Cooperatives (Cooperatives Unit, ESCS) "to conduct a national campaign to motivate cooperatives to voluntarily adopt equity redemption programs that are fair and equitable to both current and former members." We suggest the report stipulate that ESCS carry out this mandate in cooperation with SEA-Extension. This is essential and the most effective approach because of the close working relationships which exist between cooperatives and their State Cooperative Councils and the State Extension Service.

We also concur with the report findings and recommendation that the Secretary "Establish an enforcement and monitoring system to ensure that cooperatives don't use monopolistic or other unfair trade practices to raise prices unduly." The Department is proceeding to formally establish a monitoring system and enforcement procedures as announced on July 27, 1978. This system will be administered independently of the responsibilities of information and assistance to cooperatives delegated to the Secretary under the Cooperative Marketing Act of 1926.

The following expands upon those areas where we have difficulty with the report:

Cooperative "Principles" Not Needed

We do not agree with the report recommendation to "develop jointly with the Federal Trade Commission and the Department of Justice a set of cooperative conduct principles." The "principles" outlined on p. 31 are unnecessary and shallow. Some would prohibit already illegal practices. Others are too vague to be operational.

The report states (p. 30) that documented examples cannot be cited where cooperatives are now engaging in unfair methods of competition or unfair trade practices. The fact is that there already exists a set of laws that do apply to cooperatives and other businesses regarding such conduct. Furthermore, if instances can't be cited since enactment in 1937, there is little reason to believe such conduct principles are needed at this time.

Unfair practices are measured in the appropriate market. As noted in the report, some behavior that may have undesirable results may be prohibited in some markets, but the same behavior may have desirable results in others. The ambiguity is obvious. It would appear prudent to take the course, consistent with our legal system, of permitting certain action unless the results are undesirable. To do otherwise will saddle cooperatives with further constraints on their operating business practices; this can only serve to inhibit the operation and viability of cooperatives.

The section dealing with the Agricultural Marketing Agreement Act implies a strong relationship between marketing orders and cooperatives. Cooperatives play an important role in milk orders. On the other hand, there are orders in the fruit and vegetable area covering over 30 commodities; yet strong cooperatives are present in only a few. Cooperatives are non-existent under some fruit and vegetable orders and coincidentally existent under most others.

The report recommends incorporating a set of cooperative conduct principles in future market orders using the authority in the Agricultural Marketing Agreement Act for prohibiting unfair trade practices. We feel this would be undesirable. The unfair practice provision of the Agricultural Marketing Agreement Act is an incidental provision and there is no indication that it was intended to be used as a tool to police the conduct of cooperatives. If, after all these years, it was to be used for that purpose, there should be some new legislative authorization.

The report also discusses "production control" under marketing orders, a practice not authorized under the enabling statute. This issue should be clarified.

"Equity Redemption Practices . . ."

We agree with the recommendation that the Secretary require the Cooperatives Unit, ESCS, "to conduct a national campaign to motivate cooperatives to voluntarily adopt equity redemption programs that are fair and equitable to both current and former members." However, we do not agree with the recommendation that if the above effort fails, that the Secretary should develop a legislative proposal making payments on certain equities mandatory.

The report fails to make the distinction that when a decision is made to allocate part of the patronage refunds as retained earnings, that these retained earnings become an investment in the cooperative by a decision made by the members themselves through their elected board of directors. This practice is an age-old one that is found among cooperatives worldwide. Any repayment of this investment depends upon factors and objectives concerning the cooperative such as growth, financial well-being, membership turnover, etc. If a maturity date is placed on retained earnings, as recommended, they would cease to be equity and become a debt obligation on the balance sheet. This would erode the equity position of cooperatives and would potentially lead to their financial ruin. Further, if classified as security instruments, they may be required to register with the SEC, an additional financial burden to cooperatives. While it is true that cooperatives need to better systematize their equity revolvement programs, legislative action in this regard is unwarranted. It would simply result in another constraint that would inhibit cooperative presence as a tool for farmers.

Similarly, any requirement to pay interest on retained earnings amounts to simply an internal accounting transfer, i.e. there is money allocated as a return to capital while net savings are reduced. Cooperatives historically have followed a practice of making capital subservient to use of the organization, thereby maintaining the unique character of the organization. A recommendation to require payment of interest would alter that historical practice. We think such a determination of whether to pay interest or not should be left to the membership of such organizations and not be subject to Congressional action.

Evaluation of Technical Assistance to Cooperatives

In the report the concept of providing educational information concerning cooperatives and providing technical assistance is intertwined and confused. The roles of the Cooperatives Unit, ESCS, the State and Federal Extension Service, SEA, and other State and Federal as well as private organizations are not clearly delineated.

The report begins with the premise the Extension Service at the National, State, and university level has the capability and desire to provide detailed technical assistance to existing cooperatives in the United States. They include the Cooperatives Unit within this context, but it is very evident the report directs emphasis to Extension. [See GAO note 1, p. 75.]

Roles of Extension Service and Cooperatives Unit, ESCS: The Cooperatives Unit has five broad missions as spelled out in the Cooperative Marketing Act of 1926: (1) engage in applied research related to cooperatives -- including special studies in the United States and foreign countries, (2) acquire and publish historical and statistical data on cooperatives, (3) provide informational and educational materials on cooperatives, (4) assist newly emerging cooperatives (cooperative development),and (5) provide technical assistance in response to specific related problems.

Technical assistance is primarily designed to specifically benefit the requesting group or cooperative.

The Extension Service is primarily an educational organization providing more general educational programs on a variety of subjects to a wide range of clientele. They prepare materials and conduct training sessions on such cooperative related subject matter areas as the role and responsibility of cooperative directors and improving the overall management and performance of cooperative management and employees.

The Cooperative Extension Service has not become deeply involved in providing service to individual cooperatives in areas such as indepth organizational, financial, or managerial assistance to either newly organizing, or to existing cooperatives. And it is generally understood that service work is not Extension's role. It has also been our experience county Extension personnel have neither the time nor training to provide technical and indepth educational assistance to farmers on cooperative problems. Most cooperative educational assistance is provided by State Extension specialists designated to work with cooperatives.

Technical Assistance Provided Cooperatives: We seriously question the statement (p. 55) "that technical assistance needs of existing cooperatives are generally being met by sources currently available." As previously pointed out, there is a difference of opinion as to what constitutes technical assistance as distinct from educational assistance to cooperatives. According to the report, investigators visited cooperatives, various agencies, and university representatives and others in eight States. The report cites fieldwork performed by ESCS in Alabama, Missouri, California, North Carolina, Minnesota, Wisconsin, Virginia, and Kansas. Investigators contacted local and regional cooperatives, but the theme continues that the Extension Service, universities, and State Departments of Agriculture, carry on a viable cooperative technical assistance program. Although the report cites the number of requests received by specific agencies or organizations, it fails to mention the number of cooperatives assisted.

We agree educational assistance, largely using Cooperatives Unit materials, is more widely available than is technical assistance. Further, we agree the Extension Service, in cooperation with ESCS, has a crucial role to play in educational programs for cooperatives. Several States conduct educational programs for youth and cooperative directors and management on cooperative organization and principles. Few, however, provide any detailed technical assistance to cooperatives. Appendix A lists specific technical assistance projects, either completed or ongoing in the States surveyed by GAO and the cooperating organizations and agencies working on these projects which the report failed to identify or mention.

Program Planned for Cooperative Development Needs to be Coordinated: A major concern expressed in the report is the need to coordinate the establishment of field offices with the Extension Service. The inference that the Cooperatives Unit field offices have been established or even planned without close coordination and support of concerned State Extension Service is simply unfounded. Present field offices have had the support of the State Extension Service where they are located, as well as the support -- including financial support, of other State agencies. Other field offices will not be established without justification of the need and the support of SEA - Extension and appropriate State Extension Service and other agencies.

Internal preliminary budget planning has involved discussion of the possible establishment of additional field locations. However, before any are established, they will have the support of the Extension Service and other appropriate Federal and State agencies and organizations.

Following are the procedures used in establishing the two existing field offices:

North Carolina

Prior to the establishment of the field office in North Carolina in 1959, representatives from the Cooperatives Unit met in Raleigh with the Assistant Director of Extension, the State Director of the Farmers Home Administration, and other interested agency representatives. At that meeting, it was outlined that the purpose of establishing the field office was to assist a number of cooperatives in eastern North Carolina in conjunction with the sponsorship of the North Carolina Rural Fund for Development. It was emphasized that in order for the cooperative development effort to be successful, it would require assistance from all interested agencies in the area.

The plan of work for the ESCS staff person and the co-op clientele to be served were outlined to them. They supported the project 100 percent. Shortly thereafter, the State Extension Service assigned a livestock specialist to the initial project to assist ESCS.

The assistance provided by this specialist, together with the help of the 10 area county agricultural agents, was well coordinated. This cooperation has continued to the present.

California

The field office opened December 5, 1977 in Salinas. The establishment of the office was initiated by a request from the State of California after one of their employees visited the North Carolina field office. Cooperative Program representatives made several visits to determine the need for the field office, the clientele groups to be served, and the support that various agencies in California would lend to the project. During these visits, contact was made with the Associate Director of Cooperative Extension, University of California at Berkeley. Contacts were also made with various State representatives, local county agricultural agents, bankers and others in the area. The local Extension Service, with the full support of the State Extension Supervisors requested that the ESCS office be established in the County Extension Office in Salinas. We fully supported that request and the office was established in the County Extension building. The Extension Service technical assistance and physical support, including secretarial help, have been most helpful.

As noted earlier, we believe this report addresses several important cooperative issues. The treatment of most we believe is adequate; however, there are some issues we believe require additional analysis. These comments are offered to give constructive suggestions for strengthening the report and to improve its accuracy. Two recent analyses of the National Antitrust Commission report by Dr. W. F. Mueller and Loyd McCormick are attached. There are some cogent observations in these statements that should be source material for this report. We have also attached a list of technical and editorial changes we suggest be incorporated into the final report.

Sincerely,

Kenneth R Farrell

KENNETH R. FARRELL
Administrator

Attachments [See GAO note 2.]

GAO Notes: 1. Agricultural officials said that, because we revised the report to clearly show that it deals with both technical and educational assistance to cooperatives, their comment is no longer applicable.

2. The attachments were not included as appendixes to this report.

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

BUREAU OF COMPETITION

Mr. Gregory J. Ahart
Director, Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

2 APR 1979

Dear Mr. Ahart:

Your March 15 letter to Chairman Pertschuk requesting comments on the draft GAO report on agricultural cooperatives has been referred to me for reply. The following are staff comments which do not necessarily reflect the views of the Commission or any individual Commissioner, but do reflect the views of the attorney staff most familiar with agricultural cooperatives. Because the Commission has a case in adjudication involving alleged violations of the antitrust laws by an agricultural cooperative (Sunkist Growers, Inc., Docket No. 9100), staff comments are thought to be more appropriate.

The major focus of these comments will be on the recommendation at page 33 of the draft report that the Secretary of Agriculture should work with the Commission and the Justice Department to develop principles of conduct for cooperatives. The report suggests that these principles could deal with possible abuses of cooperative marketing power and could clarify federal policy regarding cooperative activities.

We believe the suggestion that the Secretary of Agriculture, the Commission and the Justice Department work together to develop principles of conduct for cooperatives may have merit, but that there are inherent limitations on the usefulness of such principles. The principles suggested by GAO's consultants illustrate both the advantages and limitations of such principles.

Many of the suggested principles of conduct are very broad and vague. As such, they may be useful in setting broad parameters within which cooperatives may operate. There is doubt, however, whether they would provide totally satisfactory guidance for the day-to-day operation of a collective marketing organization.

For example, one of the principles would set forth an obligation on the part of a cooperative "to maintain an open competitive market for all producers," although the obligation would not be absolute but rather would apply "whenever feasible."

Mr. Gregory J. Ahart 2

The difficulty of defining an "open competitive market" or arriving at objective criteria for determining when it is "feasible" to maintain such a market illustrates the problem. This is true even though we recognize that the suggested principles are only presented as a starting point for discussion.

Another difficulty with broad, general principles is that they may unnecessarily impede the activities of cooperatives. For example, one of the suggested principles is that marketing agreements between cooperatives and their members not "exceed normal industry practices except where demonstrably necessary to maintain liquidity and solvency." Putting aside the ambiguity of the word "exceed" in this context, such a principle of conduct could unnecessarily limit innovative marketing techniques if cooperatives felt that they were restricted to historical practice. It could also have the effect of appearing to permit unnecessarily anticompetitive arrangements which may have been used for some time in a few industries (particularly those dominated by cooperatives), while generally prohibiting identical arrangements where they were not "normal industry practices."

Several of the other suggested principles appear to state maxims of antitrust laws. We are happy to endorse the general concepts set forth in the following suggested principles:

-- Cooperatives shall not limit or set up devices which have the effect of limiting the total quantity of production of its members except under the explicit provisions of marketing orders.

-- Cooperatives shall not engage in any practice which will have the effect of coercing producers to join cooperatives.

-- Cooperatives shall not engage in any practices that will have the effect of removing competitors as a competitive element in a market.

-- Cooperatives shall not establish supply contracts with buyers when the effect of such contracts will eliminate a market outlet for noncooperative producers or competitive marketing firms.

We would also endorse the general concept embodied in the following suggested principle if the bracketed language was dropped:

-- Cooperatives shall not restrict their memberships except where such restrictions are demonstrably necessary for reasons of capacity utilization, physical efficiency of operation, [or product demand].

Since the foregoing principles are in large part embodied in the antitrust laws, any adoption of a set of principles of conduct should not imply that conduct prohibited by them was previously lawful.

Despite our agreement with the general propositions set forth above, we do not believe that a comprehensive and specific set of antitrust rules for cooperatives can be developed. For example, conduct which may be perfectly lawful and even procompetitive on the part of a small cooperative could be an act of monopolization on the part of a cooperative with a dominant position in a market. A detailed understanding of the structure, conduct and performance of a particular market is necessary before any comprehensive set of specific standards of conduct could be developed which would guarantee freedom from antitrust liability. As you know, there are a wide variety of markets within which cooperatives operate and substantial differences among cooperatives in terms of their methods of operation and economic significance in various markets. Because of these facts, it is doubtful that any uniformly applicable rules could be developed which would do more than set forth general principles subject to the limitations noted above.

We will be happy to work with the Secretary of Agriculture and the Justice Department to develop principles of conduct for cooperatives. We believe, however, that the inherent limitations of such principles should be clearly understood before this project is undertaken. Further issues to be explored in this regard are the legal significance of a set of principles "included as terms and conditions in future marketing orders" and how a decision would be made that they were not warranted "because of marketing conditions."

Our remaining comments deal with statements made by cooperative officials which are set forth on pages 24 and 25 of the draft report. First is the statement that USDA's work to assist cooperatives has been neutralized in part by the Federal Trade Commission, Department of Justice and the Securities Exchange Commission "competing for regulatory jurisdiction." The Federal Trade Commission has not and does not seek to regulate cooperatives. The Commission's involvement with cooperatives has been confined to antitrust law enforcement and economic studies.

Mr. Gregory J. Ahart 4

Second is the statement that one cooperative which controlled 50% of a particular commodity "decided not to expand its market share" because of possible legal action by the Commission or the Justice Department. If this occurred, it would seem to be an example of effective antitrust deterrence. As a general proposition, any producer which controls 50% of a market has or approaches having the power to raise prices and exclude competitors. This is the essence of monopoly power with all its anticompetitive and anti-consumer consequences.

Finally, the statement is made that a cooperative "passed up two opportunities to become more self-sufficient in the manufacturing of products it desired to handle" because of possible legal action by the Commission. Without more detail, it is impossible to know whether this self-sufficiency might have been at the expense of producers who were not members of the cooperative or might have had other anticompetitive effects.

We hope the above comments are helpful to you in the preparation of a final report.

Very truly yours,

James H. Sneed
Assistant Director
Bureau of Competition

UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the
Division Indicated
and Refer to Initials and Number

MAY 30 1979

Mr. Allen R. Voss
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

This letter is in response to your request for comments on the draft report entitled "Family Farmers Need Cooperatives --But Some Issues Need To Be Resolved."

We have carefully reviewed the draft report and generally support the General Accounting Office's (GAO) contention that independent family farmers need to continue to act together through cooperatives for the joint marketing of their produce. We also agree with the report that more needs to be done to prevent, eliminate or even monitor cooperative activities to guard against undue price enhancement and other unfair practices, and that other solutions are required.

With regard to the matters discussed in the report, we differ with some of GAO's conclusions and point out some important issues that are not addressed in the report. Our comments are referenced by chapter, subject matter, and page to the section of the draft report to which they pertain.

I. Chapter 3 - Protection Against Possible Cooperative Abuse of Market Power

A. Mergers and Marketing Agencies in Common (pp. 20-25)

The Capper-Volstead Act (7 U.S.C. Sections 291 and 292), which grants farmers the right to form cooperatives, creates the potential for cooperative monopoly. While the draft report recognizes

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the potential for abuse of cooperative market power, it concludes on page 20 that legislative revisions to curtail such activities as cooperative mergers, marketing agencies in common, and other intercooperative agreements which result in a substantial lessening of competition, are not warranted and "could adversely effect /sic/ the cooperatives' ability to serve family farmers." We disagree with this point of view.

The National Commission For the Review of Antitrust Laws and Procedures noted in its report to the President that it is normal and healthy for individual cooperatives to compete with each other, not only in the sale of commodities, but for membership of farmers as well. 1/ However, mergers between cooperatives, and certain joint marketing agreements, can eliminate this competition and create the potential for monopoly. Accordingly, we believe that cooperative mergers whose effect may be substantially to eliminate competition or tend to create a monopoly should be prohibited under Section 7 of the Clayton Act in the same manner as analogous corporate mergers. Further, since a common marketing agency can be the functional equivalent of a merger, we believe that such arrangements should be subject to the same competitive scrutiny as cooperative mergers and permitted only where no substantial lessening of competition would result. These approaches would bring the treatment of cooperatives, once formed, more into line with that of ordinary business corporations. Because the determination of competitive impact would take into account the peculiar characteristics of cooperative marketing and agricultural production, we do not believe that farmers would be placed at a serious competitive disadvantage.

1/ Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures ("Commission Report"), Vol. I, p. 261 (January 22, 1979).

B. Section 2 of the Capper-Volstead Act (pp. 25-28)

Section 2 of the Capper-Volstead Act authorizes the Secretary of Agriculture to prevent undue enhancement of prices by cooperatives that monopolize or engage in restraints of trade. As previously noted, we agree that the present system of enforcement does not adequately protect the public against undue price enhancement by cooperatives. As part of the effort to address this problem, the Department's Antitrust Division is participating in an interagency task force created for the purpose of examining the U.S. Department of Agriculture's (USDA) role in carrying out its responsibilities under Section 2 of the Capper-Volstead Act. Two important issues currently under discussion in that forum are the appropriate definitions to be used in identifying (1) cooperatives engaged in monopolization and (2) unduly enhanced prices. The draft report does not address these issues, resolution of which could play an important role in determining the ultimate effectiveness of Section 2 enforcement. The Antitrust Division has advised the task force of the approaches believed necessary and proper in this regard.

First, the Antitrust Division explained that monopolization consists of (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen or historic accident.2/ The Antitrust Division also emphasized that proof of undesirable, coercive, or illegal acts is not necessary to establish monopolization. Regardless of its intent, an enterprise may be found to have monopolized if it has achieved a monopoly by maneuvers which, though "honestly industrial," were not economically inevitable, but were rather the result of the firm's free choice of business policies.3/

2/ United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

3/ See United States v. Aluminum Company of America, 148 F.2d 416 (2d Cir. 1945) and United States v. United Shoe Machinery Corp., 110 F. Supp. 295 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954).

In the Department's view, it would be incorrect to equate monopolization with illegal or coercive acts, since that would unjustifiably restrict the power of the Secretary of Agriculture to protect the public from undue price enhancement.

Second, with respect to "undue price enhancement," the Capper-Volstead Study Committee at USDA has considered a proposal that would limit the definition to instances in which a cooperative using illegal or coercive acts obtains prices higher than those obtained by a cooperative of comparable size which did not engage in illegal or coercive acts. Under this proposed definition, the relevant standard would be those prices expected to result from the existing market where a cooperative, even though dominant, behaves in an exemplary fashion. It is irrelevant, for purposes of this definition, what prices would result from the operation of a competitive market. It is the Department's view, however, for the reasons explained above, that the relevant standard should not focus on conduct and should be broad enough to include both increases and maintenance of prices at levels higher than those that would exist if there were no restrictions on entry into the market.

The Department supports GAO's suggestion on page 28 of the draft report that USDA separate its cooperative promotional activities from its enforcement responsibilities under the Capper-Volstead Act--a recommendation already made by the National Commission for the Review of Antitrust Laws and Procedures. This would avoid conflicts of interest and allow each function to be more effectively and vigorously pursued.

C. The Agricultural Marketing Agreement Act (pp. 28-31)

The draft report notes that the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. Sections 601-624) "authorizes the Secretary of Agriculture to include in marketing orders terms and conditions prohibiting unfair methods of competition and unfair

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trade practices." The draft report recommends that USDA develop, jointly with the Federal Trade Commission and the Department of Justice, a set of cooperative conduct principles and include them as terms and conditions in future marketing orders. GAO's apparent intent in this regard is to clarify Federal policy regarding cooperatives and thereby prevent cooperative abuses.

We seriously doubt that an attempt to develop codes of competitive conduct would be productive. As the draft report correctly points out on page 30, various kinds of trade practices can be procompetitive or anticompetitive depending on market conditions. Similarly, the competitive impact of conduct can differ because of the product involved, the geographic areas involved, the size of the firm utilizing the practice, the competitive structure of the market, the time when it is being used, and other similar factors. As a result, we believe it unlikely that a meaningful code of conduct could be developed that would cover all commodities and at the same time assure that competitive vigor in a particular commodity would not be artificially and unduly limited. Moreover, any code would need regular and continuing amendments to take into account changing market conditions. There may well be instances where the Secretary of Agriculture, under his existing authority, will want to prohibit certain kinds of conduct by tailoring a specific marketing order to fit the circumstances of the case. We believe that this approach, together with continued enforcement of the antitrust laws against cooperatives by the Department of Justice and Federal Trade Commission, and effective enforcement of Section 2 of the Capper-Volstead Act by the Secretary of Agriculture, will adequately protect consumer interests without unduly restricting cooperative growth.

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II. Chapter 4 - Corporations and Agricultural Cooperatives (pp. 34-45)

Although the Capper-Volstead Act permits corporations to be members of agricultural cooperatives, the draft report questions whether it is in the best interest of the Nation to allow non-family farm corporations to be members of cooperatives. We share the concern about possible abuse of the cooperative form by large agri-business corporations affecting not only the viability of the family farm but also the vigor of competition in the agricultural sector. We believe that additional factual information on the role of corporations in agriculture needs to be developed by USDA before this question can be adequately addressed. Specifically, more information is needed on the identity and size of the corporations involved, their degree of influence over cooperative activities, their influence in the markets involved, and whether their cooperative status shields them from competition or enables them to engage in anticompetitive actions or agreements which, absent their cooperative status, would be disallowed. This type of information would enable Congress to assess more accurately the policy options and perceived consequences mentioned in the draft report.

III. Chapter 5 - Farmer Membership Equities (pp. 46-52)

In its discussion of membership equity repayments, the draft report implies that there exist large amounts of cash or other liquid assets readily available to make such payments. This may not be the case. We have received reports, albeit unsubstantiated, that some cooperatives have invested members' equities in fixed plants and equipment so that equity funds are not available in any liquid form. In other cases, it has been reported that equities have been used to cover operating expenses and very little, if anything, remains to repay members. If these kinds of situations are widespread, any legislative effort to improve equity redemption programs could be seriously hampered.

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We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact us.

Sincerely,

Kevin D. Rooney

Kevin D. Rooney
Assistant Attorney General
for Administration

(024360)

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