Economic Efficiency in Cooperatives

Philip K. Porter and Gerald W. Scully

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PHILIP K. PORTER and *GERALD W. SCULLY*
University of South Florida *University of Texas at Dallas*

I. INTRODUCTION

THE cooperative form of business organization has deep historical roots in the economy. The cooperative dairy association movement began in New York in the mid-1800s as a response to the monopsony power of privately held milk-processing plants.[1] It was perceived that a producer cooperative had the ability to produce processed cheese from its members' raw milk at a lower per-unit cost than would have been possible by contracting with a geographically isolated, private, for-profit firm. Modern refrigerated transportation has diminished monopsony power. In modern times, the cooperative form of business has been consciously nurtured as a matter of public policy. The tax laws of the United States exempt cooperatives that meet certain requirements from payment of income taxes.[2] Certain other pecuniary advantages are available to agricultural cooperatives. Loans are available to cooperatives at a below-market rate of interest. The collective knowledge of the Department of

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[1] For a historical discussion, see Henry E. Erdman & Grace H. Larsen, Revolving Finance in Agricultural Cooperatives (1965).

[2] In general, these requirements consist of the following: (1) the cooperative must be a nonprofit organization; (2) the cooperative may pay interest on members' shares not to exceed 8 percent per annum or the legal rate of interest in the state, whichever is greater; and (3) cooperatives may not maintain more than reasonable financial reserves nor conduct business with nonmembers in value more than 15 percent of the value of its business, and such business must be conducted at a zero-profit rate. Cooperatives adhere to these conditions and are exempt from income taxes. The advantage of the tax exemption to the cooperative is that capital inputs may be employed at a before-tax rate of return that is below that of private firms, and, therefore, can produce output at a lower average cost.

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