

In this case a new legal unit obviously does not cover a separate economic unit, but only a part of an economic unit. All economic functioning of such a stock company can be adequately understood only as the economic behaviour of a branch of the parent enterprise, pretending legally to play the role of a separate business unit. The legal mask of separate enterprise conceals and distorts all the structural and functional characteristics of such an organization. Thus the profits or losses of such an enterprise obviously do not represent entrepreneurial profits or losses, but in a strictly economic sense are only ledger items on which a computation of the entrepreneurial income of its parent enterprise may be based. In fact, virtually all the bookkeeping of such a subsidiary is hardly more than a special account in a ledger of the parent economic unit. Hopeless confusion cannot be escaped in the interpretation of such branches of enterprises, incorporated as independent legal units, unless we constantly keep our eyes on the wide discrepancies between their economic character and legal form and do not forget that all structural and functional terms employed in the description thereof are wholly conventional.

- b) An economic unit incorporated as a legal unit represents the only case where the legal superstructure of the economic body of organization corresponds exactly to every structural and functional characteristic of the economic unit. The legal concept of the stock corporation is designed to represent an economic unit. This is the only case where the legal terms relating to all structural and functional details of a stock company become perfectly synonymous with corresponding economic conceptions; thus:
- (1) capital stock represents truly entrepreneurial capital of the acquisitive economic unit;
  - (2) profits or losses of such a corporation are entrepreneurial profits or losses;
  - (3) a body of common stockholders in such a company is the true corporate collective entrepreneur of the economic unit;

- (4) dividends on common stocks of the company represent fractions of true entrepreneurial income, divided among participants (fractions) of the collective entrepreneur;
- (5) only the holders of common stock with power to vote are the true participants (fractions) of the collective entrepreneur in such economic units;
- (6) the holders of fractions (common stocks) of entrepreneurial capital have the right of fractional voting through the legally complete body of stockholders; their fractional voting power corresponds to their shares of entrepreneurial capital, hence –
- (7) voting by stocks is an innate irrevocable feature of incorporated collective economic units.

In popular usage the legal terminology relating to collective economic units gradually replaces the economic terms and such legal designations as capital stock, dividends on stock, etc., are uncritically employed as exact equivalents of corresponding economic characteristics and conceptions. Such replacement is defensible – though not imperative – in the only case of perfect coincidence of legal and economic unity of organizations – that is, in case b. In all cases (a and c), deviating from this standard, the legal terms do not reflect exactly the economic connotations they supposedly express and create much confusion. Meanwhile legal terms predominate in common use in describing incorporated economic organizations to such a degree that the economic terms are almost entirely abandoned and economic conceptions remain foggy and underdeveloped. This confusion of terms and nebulousness of conceptions is seriously impairing the analysis of the parts of economic units, incorporated as independent legal units (case a) and is particularly detrimental in all attempts to interpret the pluralities of economic units incorporated as single legal units (case c).

c) A plurality of economic units incorporated as a single legal unit. This case should be examined with special care, since the cooperative organizations belong to this type of economic formation. As in the case of the parts of an economic unit incorporated as legal units (case 1) the incorporated pluralities of economic units under the title of stock corporations (case 3) represent an obvious conventionality. A legal unit in this case covers coordinated functioning of many economic units. Such stock corporations, if taken simply as a collective enterprise (case 2) have, in fact, nothing in common with the collective acquisitive economic units. Such a stock corporation, being a legal unit without an economic entity of its own, is not capable of performing any of its own economic functions which are actually performed by the economic units composing its conventional body: it does not acquire nor spend, just as the flock of birds by itself does not fly. As a flock is only a group of flying birds, this stock corporation is only a group of acquiring (enterprises) or spending (households) economic units. The sharp incongruity of legal and economic contours, exhibited by pluralities of economic units incorporated in the form of legal units (stock corporations), if it remains unnoticed, frustrates every conceivable effort to make a coherent economic analysis and interpretation of such organizations. Almost every term describing such stock corporations is void of corresponding customary economic connotation. The following illustrations reveal the irreconcilable discrepancies:

- (1) As aggregates of economic units the stock corporations under examination are inherently non-acquisitive (non-spending) organizations and therefore their cash surpluses (or deficits) do not represent their income, nor their profits (losses).
- (2) Not being collective enterprises, the aggregates cannot have a collective entrepreneur, but are controlled by a plurality of independent entrepreneurs, each representing his own individual economic unit functioning through the association.

- (3) Being, as aggregates, non-acquisitive, incomeless, profitless, and entrepreneurless economic formations, these stock corporations cannot have their own entrepreneurial capital. In other words, their capital stock has nothing really in common with the entrepreneurial capital of true collective enterprises.
- (4) Their member-stockholders, therefore, are not the fractions of collective entrepreneur; in other words, they are not identical in an economic sense with the stockholders of the true collective enterprise (case 2).
- (5) Not being entrepreneurial fractions of a regular collective enterprise, the member-stockholders of the cooperative stock corporations under discussion cannot employ the specific method of self-expression assured the participants of a collective entrepreneur, i.e., voting by shares owned.

In short, the legal structure and legal terms of the stock corporation correspond precisely to economic structure and economic terms only in cases when the true collective enterprise is embodied in a stock corporation. In all cases which deviate from this standard and unique type, the legal terms become conventional and lose their synonymy with the economic connotations.

Cooperative associations being pluralities of economic units functioning as legal units deviate sharply from the type where the legal and economic characteristics of organization completely coincide. This significant lack of synonymy of legal and economic aspects in cooperative associations has remained unnoticed by all the students and interpreters of cooperation. The mask of a legal unit covering an aggregated plurality of economic units has been always uncritically taken for the economic face of cooperative organizations. This lamentable error is one of the principal sources of the confusions and contradictions in the tests of true cooperation quoted in the first part of this study.

In connection with this discussion of legal and economic contours of economic organizations the following considerations are worthy of

note. Incorporation is not an unavoidable phase of existence for separate branches of economic units (case a) or for pluralities (case c) of economic units. Both adopt this legal procedure only if their incorporation for some reason becomes practically expedient. They can and do normally exist without incorporation, and removal of the legal toga from the incorporated cooperative aggregates does not necessarily mean their economic end; they may conceivably continue to function as aggregates without the slightest distortion of their economic character.

Both the cooperatives of the Rochdale type and the so-called non-stock, non-profit associations can be incorporated. In existing literature, hardly any doubts ever were recorded about incorporated capital stock cooperatives. They are understood as cooperative modifications of collective enterprise. Opinions about incorporated non-stock, non-profit cooperative associations are somewhat indecisive and loose, since these cooperative enterprises are deprived of all the customary features (capital stock, dividends on stock, stockholders, etc.), of a typical collective economic unit. However, they are treated by law as collective spending economic units (households) – similar to other collective households (charitable institutions, funds, church organizations, etc.). Thus the double error in current interpretations of incorporated non-profit associations can be stated; (a) they are loosely understood to be economic units, being the aggregates of these units, and (b) they are legally treated as collective households, being in most instances aggregates of acquisitive (enterprises) and not of spending (households) economic units.

The case of incorporated capital stock cooperative associations is entirely different in the minds of cooperators. These associations have all the external traits of a collective economic unit and are treated in law as collective enterprises of a peculiar kind with some modifications relating to limitation of profits, limitation of stock ownership, and limitation of voting power. Structural mimicry of the cooperatives of Rochdale pattern, in fact, is so complete and astounding, that it has always been alike deceptive to lawmakers and economists.

### **An Important Technical Confusion: Enterprise vs. Establishment**

Failure to distinguish the economic body of cooperative aggregates from their legal clothes in current discussions is not the only cause of mistaking them for enterprises. Confusion or insufficient distinction between the technical and the economic aspects of the processes of "wealth getting and wealth using activities of men" (Ely) is another source of errors. As the terms are used here wealth getting and wealth using processes are understood as the price processes and only as price processes are they thought to be of direct concern to economists; as the physical processes of production (or consumption) of tangible goods they are designated here as the technical processes and as such they are thought to be not within the sphere of the economist. These two angles under which the phenomena of wealth getting and wealth using can be contemplated and examined normally coexist but they do not always or necessarily coincide and should not be identified or confused. In this study in anticipation of this particular difficulty, the terms acquisition and spending were intentionally adopted instead of the customary but technically tainted terms production and consumption. It is of singular importance for the purposes of this study to distinguish clearly the concept of the technical unit (here designated as establishment) from the concept of the economic unit (enterprise or household).

The overwhelming majority of cooperative associations by the nature of their activities organize and run the establishments of one kind or another. Usually, they are in need of certain items of technical equipment, which require investment of capital for years of use of this equipment by the membership of the association. The stores, gain elevators, warehouses, gasoline stations, fruit grading plants, etc., represent kinds of widely used simple establishments operated by cooperative aggregates in this and other countries. Some cooperative associations are engaged in complicated processes of manufacturing: they operate dairies, cheese factories, wine cellars, factories of canned fruits and vegetables, bacon plants (Scandinavian countries), bakeries, laundries, electric lamp factories (Swedish cooperatives), the factories of fertilizers (Federazione Italiana dei Consorzi Agrari), etc. In current literature, such organizations are usually described as cooperative

enterprises, similar to any other business enterprises engaged in production of goods.

Such uncritical and loose identification of the plants, factories and other establishments operated by cooperative associations and their unions with business enterprises is further strengthened by conventionalities of accounting in the establishments under discussion, since every organized establishment of this kind has usually its own complete system of accounting: they buy products from their members or sell them goods and services at certain prices; as business enterprises they compute their costs and calculate their profits and losses.

This technical imitation of economic units by the establishments operated by the cooperatives beclouds still more their economic character and works in the same direction as the legal conventionalities previously pointed out. For the purposes of the economic analysis of cooperative organizations the concept of cooperative body should be carefully isolated from its technical sides and implications. Therefore, a brief consideration of the clear distinction between enterprise (acquisitive economic unit) and establishment is necessary.

The concept of establishment<sup>40</sup> is used here to indicate any unit where the physical processes of production or exchange of economic goods or services take place. The term thus employed relates to a technical and not to economic conception.

It is essential that the student of cooperative organizations makes a clear separation of the concept (1) of establishment as a productive unit from that (2) of enterprise as an acquisitive economic unit. As we have seen, in case of legal interference with the economic structure of cooperative associations, technical processes of production may interfere with the economic processes of acquisition, and such interference, if unnoticed, leads inescapably toward serious confusions. With regard to

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<sup>40</sup>The concepts of establishment and enterprise, as they are stated here, correspond to the conceptions of "Betrieb" and "Unternehmung" as they are used in German economic literature.

the particular case of productive and acquisitive units, at least three basic variants deserve to be specially considered:

- a) one economic unit (enterprise) may be embodied in one technical unit (establishment); illustrations: farm of an independent farmer, retail store of an independent retailer, the plant of one-plant independent manufacturer, the shop of a small independent shopkeeper, etc.;
- b) one economic unit (enterprise) may work through more than one technical unit (establishment); illustrations: one chain store company (enterprise) selling through many of its retail outlets (establishments), multi-plant manufacturing enterprise working through its several factories (establishments), etc.
- c) more than one economic unit (enterprise) may work through one technical unit (establishment); illustrations: partnerships acting through one establishment, the cartels, and some groups of trade associations using one common establishment, etc.

It appears to be self-evident that only in the case (a) when the economic unit is embodied in one and only one establishment all the descriptive technical features of such an establishment are closely correlated with and directly correspond to the economic characteristics of an enterprise functioning through this establishment: its accounting terminology, for instance, is the accounting terminology of an enterprise; its profits and losses are the profits and losses of an enterprise; and so forth. In all cases, however, where the aberration of technical and economic shades takes place (cases b and c), all technical and accounting terms habitually used lose their customary economic connotations and become deceiving conventionalities. Thus, the economic policies of single outlets of a chain store company only indirectly reflect the entrepreneurial plan and policies of their corporate enterprise. Their profits and losses are not the entrepreneurial residua of the chain store company, but only the single items used for calculation of entrepreneurial income of these commercial leviathans. As such they are strictly identical with the profit-loss items closing the special accounts in a ledger of economic units.



In case of many economic units (case c) working through one establishment, there is a still wider divergence between the terms of accounting and the economic meanings habitually attached to them. The capital stock of such establishments is not the entrepreneurial capital of a normal economic unit, but a fund advanced by the enterprises participating in the collective work through a common establishment. The profits and losses of such an establishment have not the least kinship with entrepreneurial income, but can only be either accounts payable to or receivable from the enterprises participating in the common work in the course of mutual reckonings among the participants.

**Illustration: Cooperative Associations of Retailers in the Grocery Trade in the U.S.A.** <sup>41</sup>

Some significant developments in the grocery trade in this country illustrate clearly this distinction between a collective establishment and a collective enterprise. The cooperative associations of grocer-retailers were initiated in this country about 1887 – many years after the first commercial grocery chains were established and under their direct and powerful competitive pressure. That is, cooperation here, as everywhere, was a matter of dire necessity. Though the Atlantic and Pacific Company has been operating since 1858, the rapid growth of commercial chains in the grocery trade began after 1915. The following table gives the picture of the relative growth of chains which, as it is known, combine the wholesale and retail functions and of independent grocer-wholesalers in the grocery trade in the decade following the War of 1914–1918: <sup>42</sup>

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<sup>41</sup>Such cooperative associations of retailers were also numerous and well established in the countries of Central Europe before the current war.

<sup>42</sup>W. L. White, *Cooperative Retail Buying Associations*. N.Y., 1930. Chap. III.

**Indexes of Sales of Independent Wholesalers and  
Corporate Chains in Grocery Trade in 1919-1928**  
(Average for 1923-1925 = 100)

Years	Independent Grocer Wholesalers' Sales	Corporate Grocery Chain Sales
1919	118	45
1920	126	66
1921	93	59
1922	93	69
1923	100	85
1924	101	97
1925	99	118
1926	98	143
1927	94	174
1928	95	208

The following factors made the chain stores powerful: (a) concentration of distribution units; (b) complete food market; (c) effective propaganda that the goods are cheaper in the chain stores; (d) absorption of wholesaling; (e) clean stores; (f) privately controlled brands; and (g) special quantity discounts from manufacturers.

The retail grocers, to preserve their opportunities and their very existence, were forced to create a device working at least as well as the corporate chains. The early cooperative efforts of the retailers consisted merely in collective purchases; later warehousing, delivery service, advertising and the use of various improved merchandising plans were added.

The growth of cooperative chains of retailers was steady as the following figures <sup>43</sup> suggest:

Years	Number of Cooperative Chains
1888	1
1908	13
1910	13
1915	37
1920	90
1925	93
1927	96

In the last decade the cooperative chains have expanded rapidly, and in March 1936, there were, according to estimates of the American Institute of Food Distribution, 802 cooperative chains of grocers with 107,141 independent retailers participating. The total volume of business done through cooperative chains is considerable. Out of 400,000 food retail outlets in the United States, approximately 200,000 units are midgets of little importance; out of the remaining two hundred thousand outlets, roughly fifty thousand are owned by the corporate chains, while 107,144 retail stores <sup>44</sup> were buying through cooperatively owned and controlled warehouses (including 508 chains with 77,891

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<sup>43</sup>W. L. White, *op. cit.*, p. 15.

<sup>44</sup>*An Index to the Operating Methods of Voluntaries and Cooperatives*. The American Institute of Food Distribution, Income., New York, 1939.

retailers of semi-cooperative wholesaler-sponsored voluntary associations. The total volume of business of the cooperative chains of retailers about equals, if it does not exceed, that of the corporate chains (only approximate data are available).

One aspect of this spectacular development is of general interest. From the days of the Rochdale Pioneers the leaders (particularly English Christian Socialists, French School of Nimes headed by Prof. Ch. Gide, and others) have maintained that the consumers' cooperative stores are designed to eliminate the middlemen and particularly the retailers (non-productive agencies) from the economic scene. In our time the retailers themselves show unanswerably that they can use cooperative tools in their own interests and obviously without aspiring to eliminate profit from the existing economic order and thus to realize the ideals of Robert Owen. The fallacy that cooperative organization is a specific economic instrument of the underprivileged classes is a deep conviction in the minds of many cooperators, but the cooperative achievements of retailers are very helpful in shattering this misconception. For the immediate purposes of this study, we find in these developments in the grocery trade materials admirably adapted to illustrate the relations between technical and economic aspects in business organizations.

There are three distinctly different groups of economic organizations in the modern grocery trade in this country:

- a) independent retailer-grocers working with independent wholesalers;
- b) corporate chains combining wholesale warehousing with retail outlets owned and controlled by huge corporate economic units;
- c) cooperative aggregates of independent retailers working through their individually owned retail stores but coordinating their efforts in wholesaling through their collective wholesale establishments.

These three groups correspond precisely to the scheme previously mentioned (p. 164) as the extreme cases of theoretically contemplated combinations of enterprises and establishments:

- a) The first case (a) is the simplest one. Here we find a perfect coincidence of the economic (enterprise) and technical (establishment) contours of organizations. The independent retailer or wholesaler in this case represents the true economic unit in the sense adopted in this study and their individual establishments (store, warehouse) are physical embodiments of these economic units. Therefore the accounting terms in these stores and warehouses correspond exactly to the economic concepts they habitually express: the capital of the retailer or wholesaler is entrepreneurial capital and profits or losses are truly entrepreneurial residua.

A lack of correspondence between technical and economic aspects is traceable in both corporate and cooperative chains:

- b) The corporate chains represent economic units working through pluralities of establishments (case b, see p. 164). Single retail outlets or wholesale warehouses here are technical units, but only fractions of an economic unit. Functionally, the wholesaling and retailing here are integrated in one economic unit and all accounting terms (capital, profits, losses, etc.), in these establishments are obviously conventional without the usual economic connotations. Entrepreneurial capital and entrepreneurial income here can be looked for only in the entire economic unit comprising such multi-establishment formations. Sometimes such accounting may be attached to the wholesale establishment, but even in this case it should not be confused with this establishment.
- c) In cooperative chains we find a plurality of economic units working through a collectively owned and controlled single technical unit (wholesale warehouse).<sup>45</sup> All processes of entrepreneurial acquisition here, in contrast to the corporate chains, are decentral-

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<sup>45</sup>It is assumed here, for the purpose of clarity, that a cooperative chain has only one wholesale warehouse.

ized, and entrepreneurial income accrues to the individual coordinated enterprises. The collective establishment (warehouse) in such an aggregate performs technical functions of purchasing, storing, deliveries, etc., but has not economic functions of its own, since the members of the cooperative chain act through such an establishment. It is economically sterile and serves only as a clearing house for aggregated plurality of independent retailers. Its capital stock, if any, its stockholders, if any, its profits or losses, if any, should be thought of only as technically expedient conventionalities of accounting.

In short, a wholesale establishment in the first group is an independent enterprise; such an establishment in the second group is only a fraction of a corporate enterprise, and in the third group it is a collective establishment of a plurality of enterprises without an economic entity of its own. The economic feature common to all economic units aggregated for collective work through a common establishment, is that all the economic units participating in such collective endeavor own and operate their individual establishments (farms owned by each member of an agricultural cooperative association, stores operated by the members of purchasing associations of retailers, households possessed by every member of consumers' associations, etc.), and delegate to their collective establishment only some, and usually few, purely technical functions (baking of bread in cooperative bakeries, purchasing of commodities in cooperative stores and farmers' purchasing associations, marketing transactions for members in marketing cooperatives, etc.). The technical functions delegated to the common establishment are paid for by the participating economic units at their actual costs (hence, the cooperative principle of services at cost) proportionally to their individual use of the common establishment (hence, proportionality as a fundamental principle of cooperation).

Thus we reach a new important step in the analysis of the economic character of cooperative associations. If the cooperatives are forced by the nature of their activities to organize collectively some technical productive units, they organize them in the form of productive establishments. These establishments imitate acquisitive economic units

(enterprises) and usually are described by students of cooperation as cooperative enterprises. This misconception is, and has been for a century, surprisingly widespread among writers on cooperation, a situation that may probably be explained by the fact that the conceptions of enterprise and of establishment are somewhat loosely used in economic literature.

### Cooperative Organization as an Agency of Associated Economic Units

At this stage of our analysis it is pertinent to examine in some details the concept of cooperative organization delineated by Dr. G. Harold Powell - one of the outstanding students of the cooperative problem and a master-builder of the famous California Fruit Growers Exchange. His description of the economic nature of cooperative organization is unique in the literature on the subject because of its clarity and highly suggestive by its implications. Says Dr. G. H. Powell:<sup>46</sup>

Cooperation among farmers may be defined as an enterprise<sup>47</sup> in which the members form an agency through which they conduct the business of their greatest mutual advantage. To be cooperative it must be composed of farmers, exclusively, and managed by them, and the benefits must be returned to them in proportion to the use or the patronage of each. That

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<sup>46</sup>G. H. Powell, *Fundamentals of Cooperative Marketing*: An Address at the National Agricultural Conference, January 25, 1922. Washington, 1922, p. 3.

<sup>47</sup>In the earlier definitions of Dr. Powell the term "enterprise" was not used (see G. H. Powell, *Principles and Practice in Cooperation*, The Californian Citrograph, February, 1920, p. 100; also reference on p. 40 of this study). The term is taken here with the meaning commonly attached to it in colloquial usage and does not correspond to the concept of an acquisitive economic unit.

part of the capital necessary to create the agency and its facilities, which finds an expression in the management of the association through the voting of the members, should preferably be contributed by them in proportion to the use which each makes of the organization. And it is desirable that the capital of each member should be kept progressively proportional to the individual shipments, or purchases, or other uses made of the agency, as nearly as this may be done. Capital in a cooperative agency, which creates the permanent investment, should be considered as a means of providing the facilities needed by the members; it must not be a fund on which a dividend is paid in excess of fair rate of interest. Working capital may, of course, be provided in other customary ways. In forming a cooperative marketing association, it is fundamental that it be a proper legal entity, with sufficient powers to transact the business for which it is formed, to finance its activities, and, when necessary, to secure its obligations – thus, equally with other corporations, safeguarding the interests of its members, as well as of the institutions with which it transacts business.

Membership in a cooperative association should be confined exclusively to producers who are engaged in the production of the particular commodities with which the association is concerned and who actually use its facilities. This is a basic test of its cooperative character. Any person engaged in the same industry in the same locality should be admitted to membership without unjust discrimination. Those who would contribute capital only should never be admitted to membership, because the permanent capital should be the medium through which the members provide the facilities for the transaction of their own business; therefore, it is not desirable that permanent capital be furnished by non-producing business interests which would thereby acquire a power in the association and a voice in its direction. Membership in a cooperative organization carries with it a responsibility on the part of each member to maintain it in periods of adversity –



a responsibility which is not likely to be felt unless the organization is the farmer's own institution, developed and managed by him through his chosen representatives, to promote and safeguard his own interests.

It is not out of place here to point out that this description of the type of cooperative organization is perfectly consistent with the general pattern of cooperative organization, as an association of member-patrons, employed in this study. In the words of Dr. Powell - "This is a basic test of its [the association's] cooperative character."

One point of the formula of Dr. Powell is of special interest at this phase of our examination, namely his designation of a cooperative organization as an agency of its membership. This qualification deserves to be carefully explored.

As it follows from the context and from the very title of the address of G. H. Powell,<sup>48</sup> the pattern of cooperative association delineated relates primarily to the group of farmers' marketing associations only; besides, in his interpretation of the concept of cooperative organization Dr. Powell pursued purely practical purposes: he outlined the pattern of cooperative association which, in his opinion, would be "permanently successful";<sup>49</sup> hence the abundance of "musts" and "oughts" in his description. Despite this, Dr. Powell with his expert knowledge of cooperative organizations has made his interpretation of the economic structure and functioning of cooperatives with such clarity and insight that his fundamentals are valid almost for the entire range of cooperative associations.

An unqualified designation of a cooperative association as an agency of its members bears a certain ambiguity which can lead toward confusion unless the precise meaning of this term is pointedly stated and

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<sup>48</sup>*Fundamentals of Cooperative Marketing*, Washington, 1922.

<sup>49</sup>G. H. Powell, *Principles and Practice in Cooperation*, The California Citrograph. February 1920, p. 100.

unmistakably defined. The idea of a cooperative as an agency functioning on behalf of its members may suggest that being an agency the cooperative is an economic body by itself and is acting independently. Such implication may arise easily since the prevailing interpretations of cooperative organization are based on the same erroneous assumption and the legal conventionalities (see pp. 155-162) and habitual confusion of the technical and economic aspects of the cooperatives previously discussed (see pp. 162-171) are misleading in the same direction.

Dr. Powell himself sagaciously laid emphasis on the fact that a cooperative agency is not an independent organization but only the working tool in the hands of the associated membership when he said: <sup>50</sup>

Cooperation among farmers may be defined as an enterprise in which the members form an agency through which they conduct the business....

Powell states here with perfect transparency that the subjects of economic activities of the cooperative agency are the members of the association and, therefore, that the true cooperative association (an association of member-patrons according to Powell) has not economic functions of its own, but is only a tool facilitating activities of its members, i.e., their economic units.

That a cooperative agency has not a separate economic identity may be well illustrated by a comparison of the corporate and cooperative grocery chains just discussed. Both the corporate and cooperative chains in grocery trade are widespread in this country; we can take for the sake of direct and easy comparison the corporate chain with 300 retail outlets and the cooperative purchasing association of 300 independent grocer-retailers working in the same city. Corporate and cooperative chains in grocery or in any other retail trade are similar in this respect, that both organizations perform their purchasing transactions through one center -

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<sup>50</sup>See definition on pp. 171-172.

in the corporate chain it is its purchasing department, in the cooperative chain it is the cooperative agency (association) of the grocer-retailers. They differ in this respect, that the corporate chain, being a collective economic unit, sells its good through 300 of its own retail stores, while the cooperative chain distributes the goods through 300 associated retail stores owned and operated by the independent economic units of its members. Therefore a cooperative agency of grocer-retailers here is functionally identical with the purchasing agency (purchasing department) of the corporate chain and we can compare them directly:

- a) The purchasing department of the corporate chain being an agency of this chain and acting on its behalf on the market is part of the corporate economic unit, therefore all the activities of this department are ultimately the activities of the corporate chain: the corporate chain itself and not its department really makes all the purchases.

A purchasing cooperative association of grocer-retailers in its capacity of a purchasing agency of these grocers acting on their behalf on the market is part of the economic units of associated grocers; therefore its activities are ultimately the activities of the associated grocers: they themselves and not the association are real purchasers of the goods.

- b) Being part of the corporate economic unit the purchasing department of the corporate chain performs all the technical functions involved in purchasing of goods for the corporate enterprise, such as issuing orders, receiving and warehousing goods, their insurance if necessary, shipping and distribution of goods by request of other departments and retail outlets of the chain, etc.

Likewise being part of the economic units of associated grocers their purchasing cooperative performs for them exactly the same duties.

- c) Being part of the corporate enterprise, the purchasing department of the corporate chain performs all these technical functions at cost.

Being part of the associated grocers, their cooperative performs the same functions on the same basis (cooperative principle).

- d) The purchasing department of the corporate enterprise may have its own accounting but it cannot have its own income; its accounting records represent only the subsidiary bookkeeping data for the corporate enterprise.

The purchasing cooperative association of grocers, being part of associated economic units of its members cannot have for that reason its own income; its accounting data are nothing more than the subsidiary bookkeeping records for the associated enterprises.

- e) The purchasing department of the corporate enterprise may be conceivably incorporated as a separate stock company; this will not change in any degree its true economic character as part of the corporate enterprise.

An incorporated cooperative association of grocer-retailers still remains part of their associated enterprises and not a separate economic body.

- f) The purchasing department of the corporate chain being part of this enterprise is owned and controlled by the corporate economic unit.

Similarly the purchasing cooperative association of grocer-retailers is owned and controlled by them.

- g) The purchasing department under discussion confines its purchasing work exclusively to the needs of its corporate enterprise.

The economic services of the cooperative association of grocer-retailers are offered exclusively to the members of the association (association of member-patrons).

All these findings will be exactly the same for the marketing cooperatives if we will compare them with the sales departments of corporate economic units, or for cooperative credit associations compared with the financial departments of single economic units, etc.

The comparison of the purchasing cooperative association with the purchasing department of the corporate enterprise which is functionally identical with such an association thus reveals the fact of the cardinal significance for orientation in cooperative problem, namely, that a cooperative association is the part of associated economic units of its members, the common department of these units exactly in the same sense that the purchasing department of any enterprise is only the special branch of this enterprise through which it conducts its business transactions.

To make these remarks more general we can examine such huge economic unit as the Ford Motor Company with its numerous departments (financial, purchasing, sales, and others); each department working in its own field represents a managerial branch with certain functions delegated to it by the company; each department is a branch or part of this huge enterprise inseparable from it and inconceivable as an independent economic body. All the economic functions of these departments are the economic functions of the Ford Motor Company which conducts through these departments its business transactions.

Literally in the same sense, the purchasing, marketing, credit, irrigation, insurance, and all other cooperatives are the inseparable parts of the economic units of their members which conduct through their collective departments their business transactions. The only difference between these cooperatives and the corresponding departments of the Ford Motor Company is that while the branches of the Ford Motor Company are parts of one economic unit, the cooperative is the part of many economic units associated.

Dr. G. H. Powell himself, describing the pattern of cooperative marketing association, significantly and with remarkable penetration commented that the members of an association conduct their business through their cooperative agency; in his opinion, therefore, all the economic activities of cooperative organizations are the economic activities of the associated economic units of members and not the activities of the association itself.

In this study we have come to the same conclusions with regard to the economic nature of the activities and functions of cooperative organizations and they are described here in the same terms.

The idea of a cooperative association as a business agency of its members calls for one more remark: this characteristic is perfectly accurate for some groups of cooperatives (purchasing, marketing, credit, and some other associations); however, in a considerable sector of cooperatives the part of association is reduced to a role of a center for mutual reckonings only (insurance, irrigation societies, control associations, many livestock breeding associations, considerable number of informal cooperative groups, etc.). Thus being only partially descriptive, this characteristic cannot serve as the test of the cooperative nature of organizations. In that respect the test of the cooperative character of an association is that in all cooperatives rural and urban, informal and incorporated, elementary and most complicated, the association itself is the center where the economic activities of members are coordinated.

### **Rochdale Principles of Cooperation**

Traditionally, only reverential approach is allowed to the "Principles of Rochdale." No treatise on the cooperative movement fails to emphasize the Principles as the archstone of cooperation, its ultimate test, and its ethical and socio-economic justification. Surprisingly little attention has been paid, however, to the fact that these Principles represent cooperative "Commandments" and are completely void of explanatory value.

The Principles are usually formulated as follows:

1. Goods are sold at regular retail market prices.
2. Business is conducted on a cash basis.
3. Number of shares that one member may own is limited.
4. Dividends on capital stock are limited.
5. Profits are distributed in proportion to patronage.
6. One man - one vote.

The Principles are usually treated as all-inclusive rules, designed to give to bona fide cooperators unerring criteria in all the intricacies of their economic behaviour. Yet they were initially offered for the needs of a newly organized cooperative store in Rochdale in 1844 and, therefore, they have not and cannot have universal application for the entire range of cooperative organizations. It is not within the scope of this study to evaluate the practical significance of these Principles either for the Pioneers themselves, for consumers' associations, or for cooperative organizations generally. An item of this study is to answer the following questions regarding the Principles:

1. Are these Principles really inherent in cooperative organizations?
2. If they are inherent, why?
3. What do they reveal about the economic nature of such organizations?
4. Do they correctly, clearly and completely reflect the cooperative character of organization?

In brief, how much do they answer to the question put by Mr. R. Pattee's statement "what have we got to do to be entitled to be considered cooperative?"

For purposes of examination, the Principles may be divided into two distinct classes: the first two rules are purely practical suggestions and relate primarily to the organizers of the initial store in Rochdale in 1844. Only the last four rules, i.e., limitation of stock-holding by one member, of dividends on stock payable to members, of voting power, and of the rate of patronage dividends are generally considered as the fundamental requisites and indisputable indicators of a truly cooperative character of an association.

1. That the first rule of Rochdale, "Goods are to be sold at market retail prices," is but a practical suggestion and that this recommendation is offered primarily to the initial store and to consumers' cooperative stores generally, is self-evident. This advice obviously has not universal character and cannot be followed, for instance, by all purchasing cooperative associations - so important in our time - due to the very nature of their activities. For the Pioneers themselves, however, it was a wise warning against the temptation to win new adherents to their noble cause by price-cutting methods, which might hazard the financial stability of their weak endeavour. Not designed as a rule of permanent significance, this practical advice, nevertheless, is not only reconcilable with the conception of the aggregate structure of cooperative bodies, but finds in this assumption its final justification. For we have seen that the prices paid by members to their association in single transactions are not the prices in the exact sense of word, but only the advance payments to be corrected at the end of the business year by patronage reckonings. The members of the cooperative aggregate generally pay only the actual cost of goods and services when they purchase them through their aggregate. In other words, there cannot be any price policy of the aggregate toward its members. The true economic interest of members themselves requires that they be sagaciously overcharged at the first stage of reckoning of current transactions and thus keep their common establishment in good running shape, since, in any case, they are entitled to receive what is due to them in the form of patronage payments at the end of the business year.



2. The second practical rule of Rochdale is that "business shall be conducted on a cash basis." For the original Rochdale store with its twenty-eight members and proverbially meagre funds there was no possibility of credit sales. But the temptation to resort to credit sales was considerable. The rule was obviously adopted by the Pioneers as a specific and emergency measure for their particular case. The cooperators themselves never regarded this rule as sacred dogma, and they violated it frequently and systematically. Among the consumers' associations themselves the cases of violation of this principle are most common. It is safe to say that credit transactions, if properly conducted, are no more dangerous among the membership of cooperative aggregates than they are elsewhere. Only six years after the Rochdale store had been opened, the cooperative credit association was originated by Dr. Schultze Delitzsch in Germany, and the credit cooperatives represent now the most numerous and most powerful sector of the cooperative movement. In British India alone, there are more than one hundred thousand cooperative credit associations working successfully.

The other four rules are generally considered to be the fundamental principles of truly cooperative organizations and deserve, therefore, to be examined with special attention.

3. The principle of limited number of shares that one member may own is a specific clause relating, obviously, to a group of the cooperatives of the Rochdale pattern only (capital stock associations), and cannot be applied to non-stock associations. Being thus only a sectional characteristic, this principle cannot be considered as one disclosing the economic character of the cooperative bodies generally.

The Pioneers themselves believed unquestioningly that their cooperative enterprise was an ordinary business unit modified in such a way as to eliminate all its sinister capitalistic features. They replaced control by capital investors with democratic control. Taken by itself, this principle explains little, if anything, as to why free holding of the shares of stock is incompatible with

the cooperative character of associations. We can assume, theoretically, a regular collective economic unit (stock company) with a clause in its by-laws limiting the number of shares that can be owned by the individual stockholder, or even providing for an equal number of shares per member. Yet such a hypothetical stock company will still remain a collective enterprise, i.e., an acquisitive economic unit without any elements of cooperative structure.

The current interpretations of this Principle usually lay stress on this rule, only as a safeguard to the democratic control of cooperatives. The Principle can be adequately understood, however, only if we examine it in the light of the aggregate structure of cooperative associations. As it has been stated before, capital stock of a cooperative aggregate is not entrepreneurial capital of collective enterprise dissociated into anonymous and transferable fractions (shares of stock)<sup>51</sup> but a plurality of individual advances. These advances are made by the enterprises (or households) participating in the aggregate to finance their individual transactions through cooperative associations. Such individual advances should be kept strictly proportional to the volume of business done by each member. In actual practice of cooperative associations even slightest deviations from an absolute proportionality of advances contributed and volume of transactions done are corrected by the interest payments of members which exceeded their quota of transactions to the members who did not make the volume of business corresponding to their advances. Such interest payments are made under the deceiving title of dividends on stock.<sup>52</sup> Shareholding in cooperatives, thus, only reflects the potential volume of business of the individual members of the aggregate of economic units and for that reason is limited.

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<sup>51</sup>See above, pp. 135-136.

<sup>52</sup>See above, pp. 137-142.

If, in some associations, special precautions are provided against concentration of shareholding, it is only a device to safeguard the economic homogeneity of the aggregated membership – an essential prerequisite of its vitality and stability.

4. The Principle of limited dividends on stock is one of the most revered commandments of cooperation. This rule has always been promulgated as a device invented by the Pioneers of Rochdale in order to reduce the role of capital from mastership to stewardship, and to control profits – a sinister attribute of the capitalistic system. Our examination of the economic character of the sources of profits in cooperative aggregates has shown conclusively that in truly cooperative (aggregate) organizations the dividends on stock are not an income of the association, but merely interest reckonings among the members themselves. These reckonings rectify with perfect accuracy disproportionality between advances contributed and the use of services of the aggregate made by individual members. In spite of its strong socio-reformistic implications (the Webbs, Prof. Ch. Gide and many others) this Principle of Rochdale is very prosaic and reveals with utter simplicity that a cooperative association is a plurality of independent economic individuals coordinating their work, but each pursuing his individual economic interests most consistently and uncompromisingly.
5. Patronage dividends practice is also thought of as a device discovered by the Equitable Pioneers and designed to distribute the profit of a cooperative association among its patrons, instead of the capitalistic method of dividing it among the contributors of capital. The following sprightly comment on the subject by G. J. Holyoake<sup>53</sup> – the Herodotus of the cooperative movement – is fairly typical of current interpretations of patronage dividends:

At length the time came when substantial profits were made – palpable profits, actually paid

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<sup>53</sup>*History of Cooperation*. Vol. 2, pp. 40–41. London, 1906.

over the counter, tangible in the pocket, and certain of recurrence, with increase with every subsequent quarter day. It took some years to attain to them. But time was not counted when they did come. The fact was so unexpected that when it was generally divulged it had all the freshness and suddenness of revelation for outsiders. The effect of this patient and obscure success was diffused about, as we might say, in apostolic language - "noised abroad." There needed to advertisement to spread it.

When profit - a new name among the work people - was found to be really made by members quarter by quarter, they were copiously heard of. The cooperator who had never had any encouragement from his neighbor, felt a natural pride in making him sensible that he was succeeding. As he had never had any success to boast of before, he was not likely to make little of this. Besides his animated face suggested that his projects were prospering. He appeared better fed, which was not likely to escape notice among hungry weavers. He was better dressed than formerly, which gave him distinction among his shabby comrades in the mill. The wife no longer had "to sell her petticoat," but had a new gown and she was not likely to be silent about that; nor was it likely to remain much in concealment. It became a walking and graceful advertisement of cooperation in every part of the town. Her neighbors were not slow to notice the change in attire, and their very gossip became a sort of propagandism; and other husbands received hints that they might as well belong to the store. The children had cleaner faces, and new pinafores or new jackets, and they propagated the source of their new comforts in their little way, and other children communicated to their

parents what they had seen. Some old hen coops were furbished up and new pullets were observed in them – the cocks seemed to crow on cooperation. Here and there a pig, which was known to belong to a cooperator, was seen to be fattening, and seemed to squeal in favor of the store....

Surprisingly insufficient attention has been paid by students of the problem to this economic feature of cooperative associations. Usually the patronage dividends are vaguely described either as profit of the association distributed among its membership on the basis of greater socio-economic justice than in capitalistic enterprises or the savings of members from their transactions with the association. As has been stated previously, the patronage payments represent the final stage of reckonings between the collective establishment of an aggregate and the economic units composing this aggregate and participating in its work. To be exact, we should treat them as accounts payable to or (in cases of deficits) accounts receivable from the members on their current transactions through cooperative associations. In pure aggregates, the surpluses (or deficits) of associations have nothing in common with the entrepreneurial income of acquisitive economic units. As long as a cooperative association is treated as an enterprise and its surpluses are misunderstood as profits, the economic enigma of patronage dividends cannot be solved. This consequential error, unfortunately, is common to all current and old writings on cooperation in economic literature.

6. The *one man – one vote* rule is unique in the importance imputed to it, even among the Rochdale Principles. Unlike the first two practical suggestions or three other partial rules, this Principle is thought of as having a universal character. All cooperative associations, whether they sell goods on a cash basis at market price or otherwise; whether they distribute profits among their membership, or are non-profit organizations; whether they adopt patronage dividends or cannot observe this principle because of the peculiar character of their work, they all are obliged to follow religiously this supreme dogma of truly cooperative behaviour.

From the standpoint of all bona fide leaders and monitors of cooperation, certain departures from cooperative dogmas and some violations of the written and unwritten laws of cooperation can be tacitly tolerated to a certain extent, but the voting principle is thought to be untouchable: like the wife of Caesar, the cooperatives in this respect must be above suspicion.

All the laws relating to cooperation in all countries rely upon this formal rule as the cardinal and unerring indicator of true cooperation.

Not only enthusiasts of the socio-reformistic mission of cooperative movement accept this rule as a guiding light for orientation among the cooperative sheep and goats, but the responsible and unbiased students of the problem hold this Principle as an undisputed and an indisputable test of cooperative organization. At the First Session of the American Institute of Cooperation the following declaration was made by Dr. Ch. W. Holman – one of the leading experts of the cooperative problem:

Mr. Chairman, let me rise to object to the definition of the Department of Agriculture with respect to cooperative marketing associations or any form of cooperation in that respect. It seems to be a particularly well recognized fact among cooperatives throughout the world that an organization is not cooperative unless it votes by the man. There are variations and departures from it. In California I know they vote by trees occasionally. There is not any fundamental difference between voting by the trees and voting by the money you put in, and I stand here to challenge any of those organizations who vote by money or vote by acreage or vote by trees or by volume of products moved. I say they

are not cooperative. They are not pseudo-cooperative. They are quasi-cooperative.<sup>54</sup>

This Principle of equal voting is unreservedly accepted and religiously obeyed by an overwhelming majority of existing cooperative associations.

Finally, this Principle is unique in one more respect. All other Principles of Rochdale hitherto examined have been found perfectly compatible with the aggregate structure of cooperative organizations. An irrevocable corollary of the aggregate character of an economic body is that all relationships of economic units composing the aggregate are based on strict proportionality. Every departure from this principle, as we have seen, distorts the individuality of the participants, crates parasitic maladjustments within the aggregated body and, therefore, undermines the aggregate nature of the whole. Indeed, proportionality in the relationship of members within the aggregate is its very being. Equality, as the principle of voting, is inconsistent with the principle of proportionality underlying all other relations of members of an aggregate.

Thus this last Principle of Rochdale represents a challenge to the whole theoretical scheme outlined in this study. This basic difference can be examined with emphasis on the following points:

- a) The principle of equal voting is a legal rather than economic feature of cooperative organizations. If this rule, however, is emphasized as the cardinal requisite of genuine cooperation,

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<sup>54</sup>*American Cooperation*, Vol. I. Washington, 1925, pp. 166-167. The terms "voting by trees, by acreage, by volume of products moved, etc." indicate the voting power proportional to the economic participation of individual members in economic activities of the cooperative association, i.e., proportionally to the number of fruit trees or number of acres owned or to the volume of business done through the association by individual members.

then it should be either reconciled with the economic character of the cooperative body or reconsidered as its 'ultimate test.

- b) Actual practice of cooperatives shows that equal voting is adopted by an overwhelming majority of associations. Yet, in some groups of cooperatives, proportional voting is also in use. And there are types of cooperative associations where such a practice clearly predominates; e.g., voting by acres (irrigation cooperatives), by cows (livestock breeders' associations or cooperative control societies), by volume of products moved (some purchasing and marketing associations), etc. These procedures are not unusual among cooperators in this and in many other countries. The following two cases illustrate a spread of unequal voting in some groups of cooperative associations in the United States:

- 1) Purchasing cooperative associations of retailers in the grocery trade were surveyed by the Federal Trade Commission a few years ago. The practice of voting is described in the Report of this Commission<sup>55</sup> as follows:

The number of shares of voting stock that a member may hold may be restricted as to minimum or maximum or both, or each stockholder may hold an equal amount of stock, thus conferring an equal voice in the direction of the affairs of the company on each member. Under still another plan, each member has one vote, regardless of the number of shares he may hold. There is also the informal unincorporated type of cooperative chain in which each member has one vote. The following summary shows the basis of voting power for 100 retailer cooperative organizations arranged in six principal

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<sup>55</sup>*Cooperative Grocery Chains*. Federal Trade Commission, 1932, p. 47. Washington.



groups, according to provisions that fix the voting power:

	Number of Associations
Number of cooperative chains surveyed . . . . .	100
I. Incorporated stock companies basing voting power on number of shares of stock held . . . . .	63
a) basing voting power on unlimited shareholding . . . . .	33
b) basing voting power on limited shareholding . . . . .	18
c) basing voting power on shareholding but requiring equal shareholding per member . . . . .	12
II. Incorporated companies providing one vote per member regardless of shareholdings . . . . .	24
III. Non-stock corporations basing voting power on membership.	6
IV. Unincorporated associations providing one vote per member.	7

The summary shows that only 49 percent of the cooperatives of retail grocers observe strictly the rule of equal voting, while a majority of them violate the Principle in various degrees. It should be borne in mind that cooperative chains of retail grocers here referred to represent almost perfect aggregates of independent enterprises.

- 2) Still more telling is the case of cooperative irrigation associations in this country. They were surveyed by the Farm Credit Administration in 1938 and the following data regarding their practice of voting by members were recorded:

**Farmers' Cooperative Irrigation Societies\***  
**Number of Companies by Location and Basis of Voting**

States	Total no. of soci- eties	Number of associations in which basis of voting was:			Percent of total number in which basis of voting was:		
		One vote/ member	Water rights	Other and unkn.	One vote/ member	Water rights	Other and unkn.
Kansas	6	-	6	-	-	100	-
New Mex.	5	-	5	-	-	100	-
Colorado	419	-	415	4	-	99	1
Arizona	59	4	53	2	7	90	3
Utah	704	61	607	36	9	88	5
Calif.	615	50	529	36	8	86	6
Montana	83	7	69	7	8	84	8
Idaho	327	50	261	16	15	80	5
Nevada	45	6	34	5	13	76	11
Oregon	87	23	55	9	26	64	10
Washington	90	28	54	8	31	60	9
Wisconsin	1	1	-	-	100	-	-
N. Dakota	1	1	-	-	100	-	-
United States	2,442	231	2,088	123	10%	85%	5%

- \* F. M. Hyre, *A Statistical Handbook of Farmers' Cooperatives*. Farm Credit Administration, Bulletin No. 26, Washington, 1938, p. 254.

As the above table indicates, eighty-five percent of all reporting irrigation societies adopt the rule of voting proportional to water rights, in other words, to the number of acres of irrigated land. Only ten percent of associations follow the rule of equal voting in this group. It is to the point to add that those groups of cooperative associations in which the members have voting power proportional to their economic participation in the activities of their aggregate correspond exactly to the conception of a perfect aggregate outlined in this study.

The farmers' irrigation societies as a rule are explicitly cooperative. They are not acquisitive associations, they serve the economic needs of their members only, they do not pay any profits, they distribute their surpluses – if any – on the patronage basis, and in every other respect they follow the established pattern of cooperative bodies. The interpreters of cooperation tacitly avoid this intricate question or loosely describe these associations as "quasi-cooperative."<sup>56</sup>

- c) Such a divergence between the actual experience of cooperative associations and the fundamental dogma of traditional teachings has never been closely studied nor satisfactorily explained in existing literature. The overwhelming majority of the students of this problem acknowledge generally the principle of equality among members of the cooperatives, yet in their definitions of cooperative associations they avoid this point and do not emphasize the equal voting as the test of true cooperation.<sup>57</sup> Dr. G. H. Powell, an outstanding leader in the cooperative field, keen observer and one of the most authoritative American students of the cooperative problem, was the first who abandoned the position of blind and unreserved respect for the traditional dogma of equal voting. In his definition of cooperative association he recognized that both principles of equal voting and of voting proportionally to volume of transactions done by each member through association are compatible with true cooperation and may assure the stability and success of the cooperatives.

It is significant, however, that neither the partisans of equal voting nor Dr. G. H. Powell have attempted to explain any causal relationship between the cooperative nature of

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<sup>56</sup>*American Cooperation*. Vol. I, p. 167. Washington, 1925.

<sup>57</sup>See above, p. 29.

organization and the principle of voting in cooperative organizations. The equal voting principle of orthodox experts is considered as dogma inherited from the Equitable Pioneers, and the recommendation of Dr. G. H. Powell is but the pragmatic suggestion offered with the idea of making cooperative associations permanently successful.

- d) One fallacious assumption should be carefully avoided in the examination of this intricate question, namely the identification of a cooperative aggregate of economic units with an economic unit. Such an assumption has an important bearing on all interpretations of this intricate question. It is generally believed that the "Founding Fathers" of the cooperative movement have modified ordinary capitalistic enterprise into a cooperative enterprise, and that their revolutionary contribution was the replacement of voting by capital with voting by man in cooperative enterprises. Attention has been directed to this fallacious point of departure by unceasing propagandistic efforts of the partisans of traditional teachings and this assumption thus became the habitual point of departure in all current discussions of this question. Meanwhile, in spite of the external structural mimicry, a cooperative aggregate has nothing really in common with a collective enterprise. The voting by stocks is the very essence of the corporate entrepreneur in collective enterprises. In fact, such voting is the only channel for their entrepreneurial self-expression. The members of a cooperative aggregate, on the other hand, act within the aggregate, not as the fractions of any collective entrepreneur, but as the independent representatives and spokesmen for their own economic units working through an aggregate. The question of voting in cooperative aggregates ought to be examined from this angle only.
- e) One highly important peculiarity of voting in cooperative aggregates in contradistinction to voting by the shares of stock (voting of the fractions of collective entrepreneur) in

collective enterprises should be clearly borne in mind. In collective enterprises based on the absolute integrity and subordination of all the component parts to the will of the entrepreneur (in the broad sense of this term) the stockholders, by their voting define ultimately all the economic policies of collective economic units. In collective establishments of the cooperative aggregates, which are designed to adjust their activities to requirements of the economic units composing the aggregate, only the questions of the coordination of economic interests and economic policies of associated members are decided by voting. Generally speaking, entrepreneurial voting in collective economic units leads to dictatorial and binding decisions, while voting in cooperative aggregates has a conciliatory and advisory character and is binding only if, and only as much as, the decisions are supported voluntarily by the membership. The managers elected by the votes of stockholders in collective enterprises are within their delegated powers autocratic, while managers of cooperative aggregates elected by the votes of members have hardly more power than power of stewardship.

- f) If all these considerations are accepted they can throw some light on the question, but they do not solve the basic divergence, namely, that on the one hand the equal voting principle is not compatible with the aggregate structure of cooperative associations (as the aggregates of associated economic units they can be organized only on a basis of proportionality),<sup>58</sup> and on the other that the overwhelming majority<sup>59</sup> of these associations adopt in practice the rule "one

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<sup>58</sup>See above, pp. 119-120.

<sup>59</sup>The rule of voting power proportional to volume of business done is adopted in some groups of cooperatives with economically heterogeneous membership, such as irrigation societies, electric light and power

man - one vote." Let us examine from one specific angle this divergence between principle and practice. As has been said, every cooperative aggregate of economic units is organized and can be kept together only under irresistible pressure of dire necessity: the economic units are designed to live and function individually and independently and they gather into aggregates only if they cannot normally proceed individually. Every cooperative aggregate of economic units thus is inherently saturated with centrifugal, disruptive forces. Hence, all the problems of successful cooperative organization and work are centered around one question - how to keep associated economic units together. Hence, the innumerable difficulties connected with membership relations,<sup>60</sup> with specific difficulties and peculiarities of management in cooperative associations (actual and potential frictions, understandable as well as unjustifiable suspicions and jealousies among members, etc.), all should be carefully watched and delicately treated by the leaders at every step of their activities. Only if such disruptive forces are neutralized, or in any way are reduced to a minimum, can cooperatives function.

That is why a socio-economic homogeneity is one of the most important prerequisites of success in cooperative field: the more homogeneous is the cooperative aggregate, the more chances for its survival.

Every cooperative association is a group organization such as (a) the fruit growers' association, (b) the grain growers' elevator, (c) the dairymen's cooperative creamery, (d) the retailers' chain, etc. Homogeneity in such

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associations and some others (see pp. 196-200).

<sup>60</sup>J. W. Jones, *Membership Relations of Cooperative Associations*. Farm Credit Administration, Bulletin #9. Washington, 1936.

associationsis further strengthened by a choice of one or of few very definite economic tasks to be performed; in countries and regions with a mixed population the fact of racial homogeneity often helps to maintain successful associations. The same is true with religious and even political grouping of cooperators. In Czecho-Slovakia, with her racially heterogeneous population, there were separate cooperative unions and federations of Czechs, Slovaks, Germans, Hungarians, and Ruthenians. Besides, some of these racial cooperations were further subdivided politically into (a) agrarian cooperatives, (b) national democratic associations, (c) social democratic cooperatives and (d) communistic stores. There were definitely separate Catholic cooperative associations also. The cooperatives in Belgium are subdivided on socialistic grouping led by the *Maison de Peuple* in Brussels and Catholic Boerenbond of rural associations. Economic homogeneity of members is just as important for reduction of frictions and suspicions among members. Actually, an overwhelming majority of existing cooperative associations are organizations with distinctly homogeneous membership. A proportional voting power of such homogeneous membership is, in practice, equal voting.

Equal voting power of members in cooperative associations is thus only the special case of proportional voting. Being equal in practice it remains proportional in principle – one more deceiving feature in the structure of cooperative associations. It is of significance that this ambiguity of cooperative equality can be cleared up only after the aggregate character of cooperatives has been established. Cooperators vote equally in their associations because they are, for all practical purposes, economically equal, not because they strive for economic equality. There cannot be a more striking and persuasive illustration of this fact than the very case of the Equitable Pioneers themselves, who were perfectly equal . . . in their poverty.

- g) A small minority of cooperative associations adopt the rule of voting proportionally to their volume of business transactions through aggregates (voting by acres, by cows, by trees, etc.). Such voting conflicts with the rule "one man - one vote." It becomes unequal voting. If our assumption of the proportional character of equal voting is correct, we should expect to find, in those groups of cooperative associations in which voting is unequal,<sup>61</sup> economically heterogeneous membership. Survey of such associations shows that they, indeed, are composed of economic units varying widely in their economic capacities and in their role in the common work through the cooperative aggregate. Many Scandinavian purchasing cooperative associations adopt the practice of voting by number of shares owned by their members. These shares are distributed among the members proportionally to their volume of business through the association, or proportionally to the area of tillable land. It is not rare that among the members are found relatively wealthy landowners capable of a considerable volume of purchases, who therefore are obliged to contribute a proportionally large number of shares and therefore to have correspondingly larger voting power. In some associations a compromise is adopted providing a maximum of votes one member can have regardless of the number of shares owned. In the Federazione Italiana dei Consorzi Agrari, individual landlords are allowed to be members of the unions of primary associations and thus to have a voting power at times equal to the voting power of primary associations (proportionally to the number of shares subscribed). Patronage of such wealthy members is very important for and helpful to cooperative aggregates and they do not hesitate to grant them a voting power proportional to their purchasing capacity. Cooperative irrigation societies, because of the specific character of their work cannot

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<sup>61</sup>It is understood that admittedly pseudo-cooperative associations are not considered in this case.



eliminate from their aggregates the persons owning either relatively large areas or small lots of land within the irrigated district. However, because of strictly proportional distribution of costs of irrigation among the members of the association, they find empirically that it would be unjust and unfair to neglect such wide differences in apportionment of voting power of individual members. As has been shown in the table (p. 190), ninety percent of the existing cooperative irrigation societies in this country use a voting rule which provides for voting power proportional to the number of acres of irrigated area owned by individual members. The same practice, and for the same reasons, is not uncommon among livestock breeders' associations and among European cooperative societies for distribution of electrical energy. Membership among cooperative associations of consumers of electricity is exceptionally diverse. It ranges all the way from stock companies purchasing huge amounts of electrical power for their manufacturing establishments to the rank and file peasants, and even down to individual roomers using one or two electric lamps. Very complicated methods for the estimation of the relative economic weight of every member was in use in Czecho-Slovakia, where these associations originated in 1906. They deserve special mention, since the method of estimation used defines the voting power of each member in the association. The number of shares of capital for individual members is prorated according to their respective purchasing capacity. Such prorating is based on the following criteria:<sup>62</sup>

- a) initial fee equal for every member,
- b) number of lamps needed,

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<sup>62</sup>I. V. Emelianoff, *Kooperativnya Organizatsii aredi Zemledeltzev* (Cooperative Organizations among Agriculturalists). Prague, 1923, pp. 303-304.

- c) volume of electrical power in HP to be used for mechanical work,
- d) area of tillable land owned, and
- e). taxes paid.

The number of shares for each member thus estimated is obligatory and voting power is based on the volume of shares owned, and therefore is proportional to their participation in the activities of the aggregate, yet obviously not equal for every member.

Concluding the analysis of this most sacred Principle of Rochdale, the following summary appears to be justifiable: (a) The voting power of the membership in cooperative association, as in all other structural and functional characteristics of cooperative aggregates, is based on the principle of proportionality which is an essential feature of every aggregate of economic units. (b) proportional voting in associations with economically homogeneous membership appears to be in practice an equal voting; such an equality thus is a matter of fact and not a matter of principle in the cooperatives; the true meaning of this Principle is an appeal for homogeneousness of membership – an essential prerequisite of success for a great majority of associations. (c) In all cooperative associations with substantially heterogeneous membership proportional voting becomes, of necessity, a rule of unequal voting. It is not uncommon among them, however, that this limits the maximum of shares which may be owned by individual members. (d) Both equal and unequal voting power are inherent in cooperative associations, provided that they are based on proportionality of economic participation of the individual members.

It is a significant fact that this conclusion, extremely heretical from the point of view of traditional doctrine on cooperation, coincides with the pragmatic suggestion of Dr. G. H Powell, who recognized adaptability of both equal and proportional voting in the cooperatives,

but did not endeavor to explain why both these principles are compatible with the cooperative nature of associations.

### Summary on Rochdale Principles

An evaluation of the socio-reformistic significance and implications of the Principles of Rochdale is not within the direct scope of this study. We are concerned here exclusively with the questions:

1. Are these Principles consistent with the economic nature of cooperative associations?
2. If they are inherent in cooperative associations, why are they inherent in them?
3. What is the economic meaning of these Principles?

We can summarize our findings as follows:

- a) At least two practical rules adopted by the Pioneers (sales at market prices and on a cash basis) have nothing specifically cooperative and may be equally adopted (or neglected) by cooperative as well as by non-cooperative organizations.
- b) The other four Principles have no universal application to all kinds of cooperative associations. They prescribe the economic behaviour of cooperators rather than explain anything in the economic character of their organization. More than that, they are in need of an explanation themselves, despite the fact that for more than a century they have been emotionally regarded by all the leaders and students of cooperation, and widely accepted by cooperative associations, as the axioms of cooperative philosophy.
- c) All these Principles in an economic sense represent the corollaries of an aggregate structure of cooperative associations.

- d) Their economic meaning as analyzed in this study differs sharply from the interpretations traditionally attached to these Principles, namely:
1. The dividends on stock in cooperative aggregates do not represent profit or even income of these aggregates, but are the reckonings among the members of association and are employed as a specific device for correction of hardly avoidable disproportionalities between advances contributed and volume of business done by individual members through the aggregate.
  2. Capital stock in cooperative aggregates has nothing in common with entrepreneurial capital of collective enterprises, and the limitation of shareholding by individual members is dictated in cooperative aggregates by a necessity to keep individual advances proportional to volumes of transactions of single members through the aggregate; besides such limitations imply a desirability to maintain economic homogeneity of membership in cooperative associations.
  3. Patronage dividends in cooperative aggregates also cannot be interpreted as profits, income or savings of the aggregate; they represent a final step of reckonings between the aggregate and its members on their transactions through cooperative association.
  4. Voting power of members in aggregates to be consistent with their general structure should be proportional to the economic participation of individual members in the activities of the cooperative aggregate; such proportional voting is actually equal voting in aggregates with homogeneous membership, while it is necessarily unequal in associations composed of heterogeneous membership. Since a majority of cooperatives have fairly homogeneous membership, equal voting is a predominant feature of cooperatives. It should not be overlooked, however, that equal voting in cooperative

associations is thus a highly deceptive special case of proportional voting. Its pragmatic value and justification is in the maintenance of homogeneity of membership – an important requisite of the vitality of cooperative aggregates. Unequal proportional voting (by trees, cows, acres, etc.), is, despite deeply rooted prejudices to the contrary, perfectly consistent with the cooperative structure of associations. Limitations as to maximum votes allowable to the individual members reflect the need to check an excessive heterogeneity among the participants in cooperative aggregates.

Even though these conclusions with regard to the Principles of Rochdale diverge sharply from the traditional dogmas of cooperative philosophy, they seem to be reasonably borne out by the foregoing study.

### Origin of Orthodox Doctrine of Cooperation

The Rochdale Principles, with all the socio-therapeutic implications habitually attached to them, represent the core of traditional teachings on cooperation. The glory of the Rochdale store itself and the primacy of the Principles cannot be quite justified, if we recall that hundreds of cooperative associations had been in operation in England before the store at Toad Lane opened its doors for business in 1844. Their existence is certified by Robert Owen himself.<sup>63</sup> Prof. V. A. Kossinsky<sup>64</sup> in his study of the origin of cooperative credit associations in Germany traced their roots in the early raw materials purchasing associations of handicraftsmen in that country in 1830–1850. The acute need of credit for financing purchases of raw materials in these associations has been the principal reason for organization of the earliest

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<sup>63</sup>As quoted by G. J. Holyoake, *History of Cooperation*. London, 1906, p. 142.

<sup>64</sup>V. A. Kossinsky, *Uchregdenia Melkaho Kredita v Germanii* (Institutions of Small Credit in Germany). Annals of the Imperial University of Moscow, 1901.

cooperative credit *Verein* in Eilenburg by Mr. Bürmann. Similar credit associations existed also before 1844, e.g., in Klagenfurt (Austria) and in Laibach (Yugoslavia). The cooperative credit associations (popular banks) initiated later by Dr. Schultze-Delitzsch were designed after the pattern of Eilenburg's *Verein*. Steen Blicher<sup>65</sup> in Denmark suggested his type of cooperative association of livestock breeders as early as in 1839. Certain beginnings of cooperative organizations are recorded in New England on this continent at the end of the eighteenth century.<sup>66</sup> All these cooperative associations undoubtedly were based on the same principles of aggregated economic units and therefore the Rochdale store cannot claim any priority in development of this economic form. Yet we are not accustomed to speak of the "Klagenfurt Principles" or the "Laibach Equitable Pioneers." There obviously are some specific reasons behind such undeserved glorification of the Rochdale case at the expense of its predecessors.

Little attention has ever been paid by historians and students of cooperation to the fact that the Rochdale association was started in the thick of the Chartists' movement in England. Heavy unemployment, particularly drastic among the textile workingmen after 1825, continued for many years. Chartism developed in the atmosphere of industrial disturbances of the second quarter of the nineteenth century. The group of textile workers, as the most numerous, naturally suffered more than any other wage-earning group from the unprecedented burden of unemployment. Workingmen were passing through a period of extreme misery and degradation, and Rochdale, with its wool textile plants, bore a full measure of the hardships of the time. The Rochdalers supported with fervor the historical social movement – so colorful and rich in revolutionary songs and mottoes and so poor in any positive socio-economic program of its own. The workers of Rochdale took an active part in the revolutionary action of 1829. Several local wool textile

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<sup>65</sup>Harald Faber, *Cooperation in Danish Agriculture*. London, 1918, pp. 88–89.

<sup>66</sup>Bemis, E. W. *Cooperation in New England*. History of Cooperation in the U.S.A., 1888.