

Cooperatives in the U.S. Economy

Defining the Cooperative

A cooperative can be defined in various ways: no single definition is sufficient for our study. We describe the multidimensional character of cooperative organizations and then identify firms and economic sectors that fit within one or more of these dimensions. Our study includes a set of firms largely determined by the economic sectors identified in the original request for proposals issued by the USDA ([Federal Register, 2006](#) ^[1]). To determine whether a given firm is a cooperative, we have identified five different, potential qualifying criteria: application of a statement of principles; self-identification; incorporation status; tax-filing status; and governance structure. In some cases, these criteria are in conflict. Nonetheless, our discussion of these criteria boundaries will aid future efforts to refine our census.

Principles

Traditionally, the defining characteristics of a cooperative business are that the interests of the capital investor are subordinate to those of the business user, or patron, and returns on capital are limited. Cooperative control is in the hands of its member-patrons, who democratically elect the board of directors. Member-patrons are the primary source of equity capital, and net earnings are allocated on the basis of patronage instead of investment.

The [USDA](#) ^[2] summarized these characteristics in its definition of a cooperative as a "user-owned, user-controlled business that distributes benefits on the basis of use." A broader definition of a cooperative by the [The International Co-operative Alliance \(ICA\)](#) ^[3] employs broader terms in its definition of a cooperative as "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise." The [ICA](#) ^[3] has adopted the Rochdale principles (based on a consumer cooperative in England dating to 1844), seven world-wide, generally acknowledged principles that guide the cooperative enterprise: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training, and information; cooperation among cooperatives; and concern for community. The ICA periodically revisits these principles.

The congruence between the above definitions or principles and any individual organization could be assessed through a close reading of its bylaws and articles of incorporation. While these criteria may be useful for evaluating the cooperative character of an individual organization, they are impractical as a screening mechanism to build a census.

Self-identification

Self-identification, or the use of the term "cooperative" or "co-op" in the organization name, would appear to be one method of identifying cooperatives. Organizations operating on a cooperative basis often include these terms in their names. However, there are no established standards for the term's use. Thus, many organizations use the term "cooperative" descriptively to indicate a functional approach that includes collaboration or coordination, but they are neither owned nor controlled by patron members, nor do they distribute benefits based on use. Furthermore, some organizations that operate as cooperatives but do not use the term "cooperative" in their name. Self-identification is therefore not a reliable indicator of the cooperative nature of an organization.

Incorporation Status

Like other businesses, cooperatives typically incorporate as a legal entity under statutes that provide parameters for governance and operation. This incorporation process occurs at the state level, and specific state statutes define and describe the legal requirements for different types of entities, including cooperatives. Because the incorporation status of an organization provides some indication of its structure and operation, it is a potential indicator of whether an organization is a cooperative.

However, state statutes are not uniform. While all states have at least one statute relating to cooperatives, those statutes develop within state-specific cultural and economic conditions, and the statutory classifications and requirements for cooperatives vary. For example, many state cooperative statutes are restricted to agricultural producer enterprises. Cooperative statutes specific to sectors ranging from health to utilities, from housing to credit unions, may also be part of an individual state's business law code.

Furthermore, under some state statutes in some states, cooperatives are considered a type of nonprofit corporation, since a cooperative's primary orientation is to benefit members, providing goods or services at cost. Thus an organization incorporated under a cooperative statute may be considered a cooperative business corporation in one state, but may be considered a nonprofit corporation in another. Cooperative entities may also be incorporated under other statutes not specific to cooperatives, such as corporation, limited liability company (LLCs), or nonprofit laws. Use of incorporation status as the indicator of cooperative character does not provide a comprehensive cooperative census.

Tax-filing Status

Federal tax code requirements are consistent across all states and reflect how a particular entity operates, and thus provide another possible indication of an entity's cooperative character. The tax code provides its own set of criteria for tax filings by organizations, which may or may not include an entity's state incorporation status.

Federal tax law recognizes that cooperatives provide patron benefits instead of profits to investors, and that their residual earnings are passed through to patrons. These earnings typically are taxed once, at the patron level. The cooperative files its tax returns using a cooperative version of the corporate income tax return to qualify for the single taxation treatment. In these cases, the type of tax form submitted clearly identifies the organization as a cooperative.

Federal tax code also grants tax exemptions to certain cooperatives operating in specific sectors, treating them as not-for-profit entities. Mutual utilities, credit unions, mutual insurance companies, farm credit organizations, and some farmer cooperatives are examples of cooperative sectors that receive Federal tax-exempt designations. These cooperatives file for tax exemptions on earnings using the same standard nonprofit tax form as other nonprofit, and non-cooperative organizations. It is this tax-exempt status that identifies these organizations as cooperatives.

However, the use of tax filing forms and tax-exempt status do not provide a comprehensive cooperative census. A cooperative, or a business run on a cooperative basis, might file a standard corporate income tax return in some instances, and so could not be identified by its tax form. This situation can occur if the business does too much non-member business, or received too much non-member equity capital, to qualify for Federal tax treatment as a cooperative. Other cooperatives have Federal tax-exempt status in sectors where noncooperative, nonprofit organizations also operate. In these cases, the tax-exempt status does not provide a filter for identifying cooperatives.

Incorporation and Tax-filing Status Combined

Despite these ambiguities, cooperatives that generate the majority of cooperative business activity in the United States can be identified by the combination of the organization's incorporation status and its tax filing or tax-exempt status. Upwards of 85% of U.S. cooperative revenue is generated within six sectors: agriculture, the farm credit system, Federal home loan banks, rural electric service, mutual insurers and credit unions. Historically, the cooperative model was adopted to meet the economic challenges presented by these sectors, and incorporation statutes and Federal tax provisions were developed to support these cooperatives. As a result, incorporation status and tax filing data can be used to clearly identify cooperatives in these sectors, and is available from government or trade associations.

Agricultural cooperatives typically incorporate under cooperative statutes which exist in every state. They file tax returns specific to cooperative businesses, and are also identified by the USDA Bureau of Rural Development's periodic survey of agricultural cooperatives. Rural electric cooperatives and credit unions are chartered under specific state or Federal statutes, and Federal tax exemptions were created to support these entities. Strong, active national trade associations represent both types of cooperatives and identify and collect data on cooperatives in these sectors. Congress established the farm credit system to meet the credit needs of agriculture. Tax exemptions were created to support the system, and its nationwide network of cooperative financial institutions is well documented.

However, in some sectors where cooperatives do not use a single model for tax filing and incorporation. These include bio-fuels ^[4] (it is not uncommon for bio-fuel cooperatives to incorporate as LLCs, for example), consumer goods ^[5], arts and crafts ^[6], and social and public services ^[7] (except housing ^[8]). To gain further insight into the organizational structure of cooperatives in these sectors, we conducted a survey of >1,200 firms randomly sampled from the relevant population. **Table 2-1** reports variations in incorporation and tax filing status from this survey. According to Table 2-1, 80% of our sampled firms that incorporate as cooperatives choose to operate

and file as either a cooperative or non-for-profit organization. In contrast, only 26% of the sampled firms that incorporate as C-corp firms file as cooperatives or not-for-profit organizations. Form 1065 is used mostly by LLCs that choose to be taxed on a "pass through" basis by electing to be taxed as partnerships. **Table 2-1** allows shows that a significant fraction (15%) of sampled cooperative firms choose to file a standard business 1120 form, thus forgoing the right to be taxed as a cooperative. Overall, Table 2-1 clearly demonstrates potential ambiguities in identifying cooperatives in the U.S. economy solely from either incorporation or tax filing status.

Table 2-1: Incorporation by Tax Status(Row Percentages %, N=1,244) ¹						
Incorporation Status	Sampled Firms	990	990c/1120c	1120	Gov.	1065
(percentages)						
Cooperative	806	7	73	15	5	1
C-corp	16	13	13	67	0	7
LLC ²	51	5	5	36	0	54
Non-Profit	527	95	0	4	1	0
Other	50	11	14	54	11	11
All Cooperatives		37	43	13	3	3

¹Row percents add to 100. ²Formally, a limited liability company does not "incorporate," but, instead, organizes under the relevant state statute.

Ownership Considerations

Both incorporation and taxation reflect how an entity operates, and both recognize cooperatives as one of an array of organizational entities. As noted above, however, many situations exist where the cooperative organization does not fully fit into the existing cooperative categories for incorporation and tax filing. In these cases, to determine if an organization can be classified as a cooperative requires other criteria.

Patron ownership is a defining characteristic of a cooperative, and data indicating ownership can identify an additional universe of cooperatives. Ownership is characterized by control rights and rights to residual returns, and, in the case of cooperatives, the patron members exercise control rights by electing a board of directors, usually through a one-member/one-vote system at an annual meeting. The right to residual returns also belongs with patron members, who receive benefits based on use, including patronage refunds.

Survey questions about membership criteria, member voting rights for board elections, patronage refund allocation, and non-participation on the board by management can provide additional data on ownership for identifying cooperatives.

Boundary Issues

Organizations that are owned and controlled by patron members who receive benefits proportional to use can be identified as cooperatives through incorporation, tax filing, and member activity information. As with any taxonomy, however, questions arise when organizations meet some, but not all, of the criteria for classification of a cooperative. These variations can blur the definition of a cooperative, and pose questions about the boundaries of cooperative activity.

Nonprofit Entities

Many cooperatives are incorporated as nonprofits. This designation encompasses two different subsets. Incorporation statutes that are specific to cooperatives, but that classify them as nonprofit entities, also make provisions for member ownership rights including member voting rights for board of directors, distributions, and rights to residual returns.

In contrast, cooperatives incorporated under general nonprofit statutes are not statutorily bound to follow organizational and operational criteria specific to cooperatives, making the cooperative character for such organizations more difficult to identify. This type of nonprofit cooperative frequently appears in traditional nonprofit sectors such as education, arts and crafts, and childcare.

General nonprofit statutes permit member organizations, but may not guarantee the right of members to vote. Broader statutory parameters for board selection and governance allow membership organizations to be governed by a board that is not elected or is composed of both elected and appointed directors, as well as a board elected by a one-member/one-vote system. Membership organizations incorporated under a nonprofit statute may exhibit varying levels of democratic control by member patrons; whether such an organization is a cooperative is debatable.

General nonprofit statutes also prohibit distributing residual earnings to those who control the organization, including members. The distribution of benefits to patron members based on use is a central concept to the cooperative operation. This prohibition on distributions would seem to disqualify all nonprofit membership organizations as cooperatives.

However, this type of nonprofit cooperative typically operates in sectors commonly designated as not-for-profit and where residual earnings are uncommon. Member benefits in these cooperatives are the services provided; the member receives these benefits in proportion to how frequently the cooperative entity is used. Whether the statutory prohibition of distributions should exclude from a cooperative census a member-controlled organization providing services to its patrons poses another boundary question for this study.

Federal tax-exempt status designations present related boundary issues in identifying cooperatives. The Internal Revenue Code (IRC),^[9] provides Federal tax exemptions to cooperatives in various sectors. For example, IRC 501(c)(12) exempts benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, mutual or cooperative electric companies, (and) "like organizations". The IRC outlines specific organizational and operational cooperative principles that an organization must follow to be eligible for this Federal tax exemption. These principles center on democratic control, subordination of capital, and operation at cost, which includes the distribution of any savings to members based on their patronage. Clearly a nonprofit organization with such a tax-exempt status can be categorized as a cooperative. Tax-exempt designations specific to cooperatives in other sectors exist as well.

In contrast, cooperatives organized under general nonprofit statutes that provide services may qualify for Federal tax-exempt status under IRC section 501(c)(3). This tax-exempt designation supports, among others, organizations established for educational and charitable purposes and can be a major incentive for incorporating as a nonprofit. Such organizations are eligible to receive grants and tax-deductible contributions. Cooperatives organized to provide public sector-type services, such as education or childcare services, may have difficulty financing start-up or ongoing costs. For them, the ability to receive grants or contributions may be essential for survival.

However, tax-exempt status granted under section 501(c)(3) of the IRC^[9] requires that no part of the organization's net earnings benefit any private shareholder or individual. This mirrors the prohibition on distributions in general nonprofit incorporation statutes, and raises similar boundary issues for interpretation.

Quasi-governmental Entities

Cooperative activity within the public sector presents significant boundary issues. Governmental, quasi-public, nonprofit, and private entities may all provide public sector goods and services using public revenue. They may also share cooperative characteristics, such as a user-based representative governance system, and supply benefits that aggregate with use. Some entities are incorporated as stand-alone nonprofit agencies, may self-identify as cooperatives, or have member control characteristics that might allow them to be classified as cooperatives. However, most of these organizations spend public revenue and they typically have some mandated control or reporting requirements that are external to board control.

One method for determining whether a cooperative organization is a government entity is to consider whether the organization is included in U.S. Census of Governments^[10], Individual State Descriptions, and whether revenues and outlays are included in state government finance statistics.

In the Census definition, governmental character exists if the organization has a high degree of responsibility and accountability to the public, as evidenced by public reporting or open records requirements. This classification is independent of the tax or incorporation status.

The degree to which the cooperative board is autonomous and subject to public oversight and reporting, can differentiate these entities from cooperatives that may have publicly funded entities as members, and that may use public revenues to purchase goods or services. These characteristics may be indicated by incorporation status, tax filing status, or bylaw provisions.

Boundary questions can also develop because public accountability can characterize both governmental character and recordkeeping and reporting requirements for cooperatives in regulated industries, such as mutual or cooperative telephone or electric companies.

Limited Cooperative Associations

The limited cooperative association (LCA) is a newer type of business entity that has characteristics of both the traditional cooperative and the limited liability company (LLC). Although few in number, this hybrid form poses a unique set of cooperative boundary questions around issues of investor control.

In five states, new statutes address problems associated with cooperative capital formation. While variations exist among the statutes, all permit distribution of net earnings on the basis of investment contributions as well as on patronage, and do not set limits on investor returns. Investor voting rights and election to the board of directors are allowed. The statutes protect patron-member interests through mandated minimums for patronage-based earnings distributions, and special provisions for patron-member voting and majority representation on the board. However, by introducing investor ownership and control into the cooperative business model, the defining cooperative emphasis on patron benefits may be diluted by consideration of investor members' interests. The extent that this potential for conflicting ownership interests should exclude an organization from a cooperative census is debatable.

Besides limited liability for its members, the LCA may elect to be taxed as either a partnership or as a corporation. To be eligible for the single-tax treatment afforded to cooperative corporations, the LCA must meet the IRC-specified organizational and operational principles for operating on a cooperative basis. These principles include subordination of capital and distribution of savings based on patronage, which might not apply to an LCA making investment-based distributions. Whether Federal tax status should disqualify an organization that also encompasses patron member ownership and control requirements is another cooperative boundary question.

Partnerships, Associations and Clubs, and Employee Stock Ownership Plans

From an ownership perspective, many patron-controlled organizations in the U.S. economy would be considered cooperatives under any other criteria mentioned above (application of principles or self identification, and tax or incorporation status). Partnerships, associations and clubs, and employee stock ownership plans (ESOPs) are good examples. Professional partnerships are "labor-managed firms," much like worker cooperatives. They may use democratic governance procedures among controlling members, and it is the organization's "workers" who exercise control of the firm. Unlike most worker cooperatives, however, control is offered only to a restricted set of workers.

Many associations and clubs operate according to democratic principles and are controlled by their patrons. Like nonprofits, there are no residual returns; therefore not providing members residual returns on a patronage basis is likely irrelevant. In contrast, ESOPs do provide residual returns to workers (typically on the basis of seniority in the organization, which can be considered a form of patronage), but only limited control rights through an intermediate trust.

Coverage for This Study

So where do these boundary issues leave us in our effort to conduct a census of the "cooperative" sector? Ultimately, any categorization, whether based on economic or organizational criteria, will have boundary issues. The central challenge is to define "hard" boundaries to maximize the usefulness of the data, and to periodically reevaluate these boundaries. We use the 15 sub-sectoral, and 4 aggregate sectoral, economic categories defined by the [USDA \(2006\)](#),^[11] to identify a potential universe of firms. To classify firms that did not fit within the subsectors provided by USDA categories, we created two new subsectoral categories:

1. [Commercial sales and marketing](#)^[12]: [farm supply and marketing](#)^[13] , [biofuels](#)^[4], [grocery and consumer goods retail](#)^[5], [arts and crafts and entertainment](#)^[6]
2. [Social and public services](#)^[7]: [housing](#)^[8], [healthcare](#)^[14], [daycare](#)^[15], [transportation](#)^[16], [education](#)^[17]
3. [Financial services](#)^[18]: [credit unions](#)^[19], [farm credit](#)^[20], [mutual insurance](#)^[21]
4. [Utilities](#)^[22]: [electric](#)^[23], [telephone](#)^[24], [water and waste](#)^[25]

Most cooperatives in the 4 sectors listed above can be considered either "producer" or "consumer" cooperatives. A producer cooperative transforms member inputs into a marketable output, while a consumer cooperative purchases wholesale goods to sell to its members. Additionally, there are also "purchasing" (or business-to-business) and "worker" cooperatives that operate in a wide variety of economic sectors. Purchasing cooperatives are composed of businesses that collectively buy supplies that members use in their respective businesses. Often the businesses are retail stores that collectively purchase wholesale goods to try to establish better terms of trade. A worker cooperative is a type of producer cooperative where the input provided by members is labor. Approximately 80% of all worker cooperatives are

found in the Commercial Sales and Marketing ^[12] sector (36% consumer goods retail, 9% arts and crafts, and 33% entertainment), and the remainder are found in the Social and Public Services ^[7] sector (5% healthcare, 8% transportation, and 5% education). Approximately 19% of purchasing cooperatives are found in the Commercial Sales and Marketing sector (13% grocers, and the remainder in "other"), 66% in Social and Public Services (21% healthcare, 44% education, and 3% transportation), 4% in the Financial Services sector (corporate credit unions), and 11% in the Utilities sector (generation and transmission cooperatives). In instances where firms did not fit within the subsectors listed above, we created new subsectoral categories. These include Other ^[26] in the Commercial Sales and Marketing ^[12] sector, and Cooperative Finance ^[27] in the Financial Services ^[18] sector.

Table 2-2 summarizes economic activity across all sectors by cooperative type. The vast majority of cooperatives are owned by consumers, with most producer cooperatives existing in the agricultural sector. Overall, nearly 30,000 cooperatives in the United States account for >\$3T in assets, over >\$500B total revenue, \$25B in wages and benefits, and nearly 1M jobs. The total number of individuals in the U.S. who are members of at least one cooperative is difficult to estimate because many individuals are members of multiple cooperatives. Consequently, the number of memberships reported in Table 2-2 represents the sum of all members of all the cooperatives in the U.S.

Table 2-2: U.S. Cooperatives by TypeSummary of Key Economic Indicators

Cooperative Type	Assets	Revenue	Wages	Firms	% of Firms	Employees ²	Memberships ¹
	(million dollars)					(thousands)	
Worker ³	128.02	219.24	55.41	223	1	2.38	55.14
Producer	23,632	65,426	2,970	1,494	5	72.93	714.65
Purchasing	1,126,848	157,892	2,902	724	2	130.35	6,133
Consumer	1,975,805	291,086	19,085	26,844	92	650.65	343,969
Total	3,126,414	514,624	25,013	29,285	100	856.31	350,872

¹One member can belong to multiple cooperatives, so does not necessarily represent a unique individual. ²Employment is reported in terms of full-time employees. Two part-time workers are reported as one (full-time) employee. ³Member numbers are higher than employment figures because a) member numbers include part-time workers, but employment figures represent the number of full-time positions b) some cooperatives reported their membership but not their employment figures.

In the following Sections, we estimate the indirect and induced impacts that result from this economic activity, and report separately on the individual subsectors noted above. We also present maps that geographically locate cooperative businesses in the U.S. to provide further insight.

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Source URL (retrieved on 05/06/2010 - 08:50): <http://reic.uwcc.wisc.edu/issues>

Links:

- [1] <http://reic.uwcc.wisc.edu/ref#13>
- [2] <http://www.usda.gov/wps/portal/usdahome>
- [3] <http://www.ica.coop/al-ica/>
- [4] <http://reic.uwcc.wisc.edu/biofuels>
- [5] <http://reic.uwcc.wisc.edu/groceries>
- [6] <http://reic.uwcc.wisc.edu/arts>
- [7] <http://reic.uwcc.wisc.edu/services>
- [8] <http://reic.uwcc.wisc.edu/house>
- [9] <http://www.irs.gov/taxpros/article/0,,id=98137,00.html#irc>
- [10] http://factfinder.census.gov/jsp/saff/SAFFInfo.jsp?_pagelid=sp6_gov&_submenuid=&ds_name=&_ci_nbr=&q_r_name=&_industry=_sse=on
- [11] <http://reic.uwcc.wisc.edu/ref#refs>
- [12] <http://reic.uwcc.wisc.edu/sales>

- [13] <http://reic.uwcc.wisc.edu/agricultural>
- [14] <http://reic.uwcc.wisc.edu/health>
- [15] <http://reic.uwcc.wisc.edu/childcare>
- [16] <http://reic.uwcc.wisc.edu/transport>
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