

expectations: 29 tests out of 46 of the list are propounded by one author only and are not mentioned by any other expert. Out of 8 characteristics recommended by two authors, 4 tests contradict some of the other "essentials." Only 4 features are pointed out in three definitions, yet 2 of them are contested by other tests and the remaining 2 (mutual assistance, originated by the weak) help little in explanation of the problem. The only test acceptable to five authors (unlimited membership) contradicts the rule of restricted membership supported by other experts and the practice of some cooperatives. Out of two tests stressed by six authors one (voluntarity) has little explanatory value, and the other (union of persons) represents a misleading and, therefore, unfortunate substitute for the concept of enterprise.<sup>74</sup>

There is only one descriptive characteristic common to all cooperative associations in the opinion of ten authors out of twenty-three included in this survey. If the identification of two other formulas (union of persons, social unity) with this test is allowable, then fifteen experts out of twenty-three assume that a cooperative organization is an enterprise. As will be shown in the second part of this study, it is in this very assumption that students of the cooperative problem fatally err.

## Conclusion

This review leads to the seemingly indisputable conclusion that excepting Prof. Gh. Valenti, M. Mariani, Dr. H. Fuchs and Prof. R. Liefmann, no economist under survey endeavored to examine the cooperative problem as the problem of theoretical economics free or isolated from considerations of its practical significance (American interpretations) or its socio-reformistic potentialities (overwhelming majority of European interpreters of this problem) and strictly separated from the sociological (Prof. Tugan Baranovsky), ethical (the Webbs, Prof. Ch. Gide and many others) or legal (Ed. Jacob) implications. Gh. Valenti and M. Mariani were interested in the role of cooperative associations in the general structure of existing economic society without preliminary inquiry into the economic character of the cooperative organization itself. Prof. R. Liefmann has made far-reaching and highly suggestive remarks on the economic character of a cooperative body. He did not offer, however, a completed and coherent system of interpretation: his remarks, moreover, are conspicuously

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<sup>74</sup>See pp. 87-91.

indecisive and partly contradictory. Finally Dr. H. Fuchs' theoretical outline covers only the "productive" associations, which actually do not exist.

Thus the cooperative problem in its entirety still remains almost untouched as a problem of theoretical economics. And as long as it remains in such a state the simple question of President R. Pattee, as to what an association has to do to be considered cooperative, cannot be answered.

## **PART II**

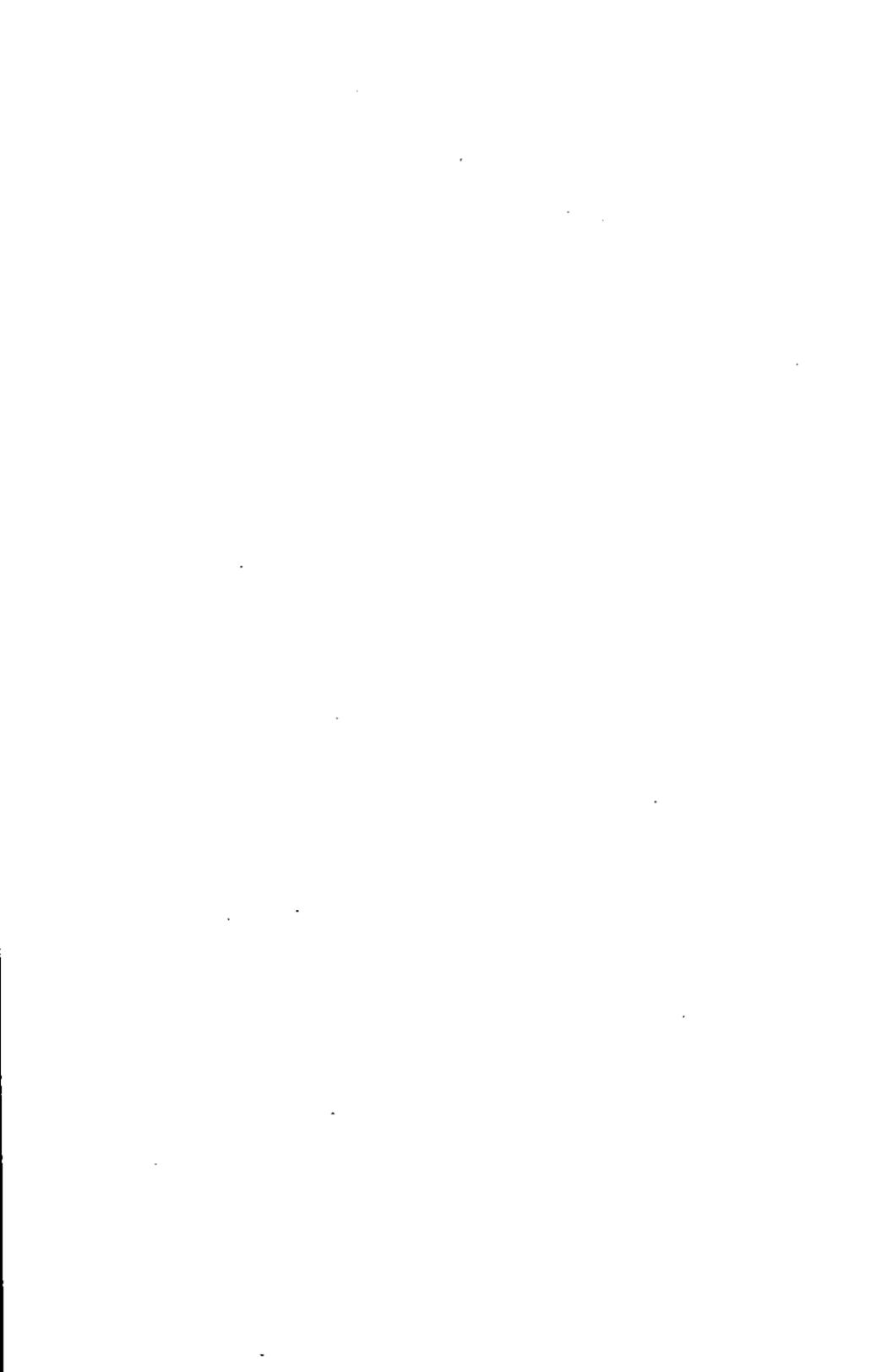
### **COOPERATIVE ORGANIZATION AS AN ENTERPRISE**

The modern economic order is built around the concept of enterprise, the correlate of which in income is profit.

G. H. Knight  
*Profit*

Our science is suffering with regard to the fixation of conceptions and terminology, from the state of dissolution which may most nearly be described as a state of anarchy.

Gustav Cassel  
*Fundamental Thoughts in Economics*



## PART II

### COOPERATIVE ORGANIZATION AS AN ENTERPRISE

#### Setting of the Problem

The fundamental errors of the surveyed interpretations of the cooperative problem are primarily methodological:

- a) indeterminateness of approach
- b) confusion of different aspects of the cooperative problem and
- c) incompleteness of the field covered by the interpretations, which leads to non-comprehensiveness of the conclusions.

Each of these three errors taken separately is sufficient to obscure the interpretative value of an inquiry, while their combination leads nowhere but toward a cumulative maze of confusions and contradictions well illustrated by the "tests" of true cooperation listed above.

A refined theoretical analysis of the cooperative problem is indispensable and the only possible avenue of approach if an explanation of the economic nature of cooperative organizations is pursued. Any practical considerations – however important – are absolutely out of place at this stage of treatment of the cooperative problem. All the socio-therapeutic doctrines either inherited from Owen or offered in our days by the Webbs, Prof. Ch. Gide, Prof. F. Oppenheimer and others are quite incompatible with the theoretical approach to the problem. If an economist in his treatment of cooperation endeavors, even with the best intentions, to direct economic behaviour, to make proposals for the cure of existing socio-economic evils or in any other way to express his views on matters of economic policies,<sup>1</sup> he necessarily departs from the

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<sup>1</sup>Even in descriptive literature on cooperation, the writers are inclined to lay certain emphasis upon the cooperatives which are "permanently successful." This tendency obviously diverts the attention of the describer from the idea of cooperative organization to that of successful organization. Meanwhile, some

realm of theoretical economics. All the interpreters of the cooperative problem surveyed in the first part of this study with the exception of M. Mariani, H. Fuchs and R. Liefmann, have failed to satisfy this methodological prerequisite.

On the other side the existing systems of theoretical economics offer no place for the cooperative problem and the subject of economic forms has generally remained almost untouched since the days of J. B. Say.

The cooperative problem is a problem of manifold aspects and may be theoretically examined in many cross-sections, but the present study is concerned strictly and exclusively with its economic aspect. For the students of cooperation this problem has been proved to be exceedingly difficult for distinctly economic examination, and probably in no other economic field have "an arbitrary way of proceeding and the influence of non-economic points of view" (Cassel)<sup>2</sup> had a more pernicious effect. Sociological, ethical, legal and technical considerations are usually interwoven with the economic examination of the cooperative problem by its students and propagandists. Only R. Liefmann, H. Fuchs and M. Mariani, among the interpreters surveyed, have succeeded in isolating the economic aspect of the cooperative problem, and, oddly enough, their conclusions sharply contradict the most widely professed and most firmly established opinions.

There is a very common mistake in the literature on cooperation: namely, to confuse economic concepts with the conventional terminology of accounting. Such terms as "profit," "capital stock," "dividends on stock," etc., when used in the writings on cooperation, should be in most cases taken with reservations. In the later chapters of this study, rather numerous cases will be cited in which a careful separation of the economic conceptions from the conventionalities of accounting seems to be imperative.

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cooperative associations cannot be successful in the pure cooperative form (productive associations), but their stability and chances to succeed increase proportionally to the degree of their departure from the cooperative type.

<sup>2</sup>G. Cassel, *Fundamental Thoughts in Economics*. New York, 1925, p. 43.

The third and the last basic methodological requirement for the proper setting of the problem under discussion is the integrity of the problem involved. A theoretical treatment of the economic scheme of cooperation cannot help to clarify the problem unless the whole range of cooperative organizations is covered by this scheme. All the concepts of cooperative organization based on the experience of single groups of cooperatives (the marketing associations described by the American students, the consumers' stores interpreted by the English and French social philosophers, the credit cooperative associations of the German economists, etc.) being partial generalizations, are inescapably misleading. It is due to this deficiency that the theoretical scheme of Dr. Hans Fuchs, despite his penetrating analysis of productive associations, cannot have a general explanatory value for orientation in the kaleidoscopic diversity of existing cooperative forms.

Finally, the object of study should be clearly defined from the very start. It is customary among the interpreters of the cooperative problem to discuss "cooperation." Yet cooperation is nothing but the conventional designation for the infinitely diverse and ever-varying cooperative organizations, their unions and federations. An economic analysis shall be directed, therefore, toward the examination of a cooperative economic type, around which all the actually existing varieties of cooperative associations are centered. It is obvious that the attention of the student should be focused primarily, if not exclusively, on the primary or elementary cooperative formation since in this very elementary cooperative cell all the basic economic characteristics of cooperative organization are concealed. The secondary and tertiary organizations of cooperative bodies (their unions and federations) being the derived forms bear certain additional or secondary traits, but they cannot have any basic (either structural or functional) economic characteristic, which is not inherent in the primary cooperative associations. A defect of M. Mariani's theoretical system is that he has endeavored to characterize the place of cooperative associations in the general structure of the market, but has not attempted to trace the innate economic features of the cooperative body itself, thereby failing to state and explain its economic nature. Thus, in all the history of cooperative doctrines, only Prof. R. Liefmann, in his study of economic forms, has formulated his idea of cooperative type of organization. His remarks on this central point of the cooperative problem are, however, cursory, incomplete, indecisive and even contradictory.

It is indeed an astounding fact that economists not only have avoided an analysis of the cooperative type of economic organization, but have felt a certain repulsion to such setting of the problem. The following dialogue from the Conference of the American Institute of Cooperation between the President of this Institute and the Leader of the Round Table Conference, one of the most authoritative students of the cooperative problem, Dr. E. G. Nourse, illustrates such an attitude fairly well:

*Dr. Nourse:* Mr. Pattee, I wondered why you suggested that we go into this discussion. What do you want to get out of it? You are the manager of a cooperative association. What good is a definition for you?

*Mr. Pattee:* I am wondering whether I am or not.

*Dr. Nourse:* Do you care? Is it just a matter of academic curiosity?

*Mr. Pattee:* I know I am the manager of an association. I just wanted to learn something myself. I have sometimes thought I was like a patient in the story who called in a specialist to diagnose his case. The doctors could not agree among themselves, but the post mortem disclosed the trouble. That is all right for the specialist, but it is awful hard on the patient.... Mr. Chairman, I want to add further, so that I may not be misunderstood, that it seems to me that there is a tendency on the part of the people to misunderstand the purpose and the intent of the cooperative movement. It may be possible to seize on that name and apply it to a process or operation, or identify it in the public mind with practices which are not the purpose and the intent and the object of those of us here who are interested in what we call the cooperative movement. I wish that in the public mind all over the country and throughout the world there could be sufficient identification of the cooperative movement so that the general public whose will will be enacted upon it through legislation, may not misunderstand the purpose and object we are after. Not that I think that it ought to be laid down in a cast iron mold, but whether it is

a commendable purpose or otherwise must stand upon judgment of the public, and the public should know the real purpose and intent back of this thing.

*Dr. Nourse:* Would you be so good as to go on and suggest what you have in mind and set yourself up as a strawman, if you please?

*Mr. Pattee:* My dear Sir – there is no man in this audience who has been so thoroughly ripped up the back and across the belly as I have been. I have been shot and perforated and filled so full of holes. I think it is somebody else's turn. Especially do I think it is your turn. I do not mean you particularly or personally, but man of your opportunities, who have had a chance to study this, because most of us have been trying to do things which we thought were cooperative but which we have been told were not by those who have studied this thing. So I wanted to know, if those who have studied it have agreed among themselves as to what it was we should do. I think it would help us very much.<sup>3</sup>

This very definition of the cooperative type of economic organization is the final goal of this inquiry. Yet the definition of cooperative organization, as it is to be understood here, is much more than "merely laying down boundary lines for the purpose of classification," as Prof. O. B. Jesness interprets it.<sup>4</sup> In the opinion of Gustav Cassel,<sup>5</sup> no name or definition should be introduced "before the thing which has to carry the name is distinctly understood. The first task, therefore, is an analysis of what is essential in the facts and relations of economic life. Not until this is clear are we able to draw distinctions which correspond to

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<sup>3</sup>*American Cooperation*, Vol. 1. Washington, 1925, pp. 164–166.

<sup>4</sup>*American Cooperation*, Vol. I, p. 161. Washington, 1925.

<sup>5</sup>Gustav Cassel, *Fundamental Thoughts in Economics*. New York, 1925, p. 43.

economic essentials and only then the time is ripe for the introduction of definitions."

It is the purpose of this study to concentrate attention on the analysis of the economic - structural and functional - essentials of cooperative organization and on the ground of such analysis to delineate the general economic conception of cooperative organization as distinct from the non-cooperative economic bodies.

The concept of the economic character of the cooperative type of organization thus developed will have its explanatory or theoretical significance only if - and only as much as - this concept -

1. Discloses indisputably the economic character of the cooperative form of organization in contra-distinction to that of all non-cooperative economic formations and helps to draw a sharp line of cleavage between them;
2. Offers a precise and defensible explanation of all the economic peculiarities of cooperative associations;
3. Presents such explanation in one coherent logical unit;
4. Considers all the diversity and infinite variability of actually existing cooperative associations;
5. Explains the remarkable economic achievements in some lines of cooperative activities and the discouraging failures in the others;
6. Throws light on the enigmatic intricacies of the geographical distribution of the cooperative movement;
7. Aids the explanation of the origin of the cooperative movement and of its historical development, and generally
8. Gives an orientation about the place and role of the cooperative movement in existing economic society.

Assumption that a cooperative association is an enterprise is the sole "test" which, out of twenty-three formulas previously quoted, is uniformly included in ten definitions of true cooperative organization (see above, p. 29): J. D. Black,<sup>6</sup> R. H. Elsworth, R. Pattee, H. Fuchs, R. Liefmann, F. Staudinger, M. Tugan Baranovsky, M. Mariani, Gh. Valenti, and H. Müller mention it in their formulas. They all emphasize this point as the basic economic characteristic of cooperative organization. Six more definitions, those of H. Filley, Ed. Jacob, H. Kaufmann, W. Sombart, A. Anziferoff, and F. Staudinger, use a supposedly equivalent phrase, "union of persons," instead of "enterprise" apparently with the idea in mind that being "unions of persons" and not "unions of capitals," the "cooperative enterprises" thus differ from stock corporations. Werner Sombart,<sup>7</sup> for instance, defines the cooperatives as the free unions of economically weak persons with the purpose to improve their economic standing by the use of large scale business methods." Then he continues:

Such a formula embraces all the real cooperative associations – productive, purchasing, marketing, credit associations and consumers' stores; on the other side it separates them from various other economic formations: from the obligatory corporations they differ in being "free"; from the stock corporations and similar forms by the term "unions of persons"; from the capitalistic cartels and syndicates by the trait "economically weak" (otherwise why is an association of carpenters a cooperative, and an association of coal mine owners a syndicate? The legal form in both cases is identical).<sup>8</sup>

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<sup>6</sup>Prof. J. D. Black uses the term "business unit."

<sup>7</sup>W. Sombart, *Der moderne Kapitalismus*, Vol. III, 2nd Half-band, §986.

<sup>8</sup>W. Sombart, §§986–987.

Dr. H. Müller<sup>9</sup> in his formula specifies the term "enterprise" by the additional characteristic "social unity" as the specific shade of "cooperative enterprise." With the exception of the sagaciously worded definition of Dr. G. H. Powell,<sup>10</sup> the other definitions quoted tacitly assume an entrepreneurial nature of cooperative organization and only emphasize the specific features of "cooperative enterprises" which distinguish them from the ordinary, speculative, or capitalistic enterprises. The sensational character of the Rochdale initiative, according to prevailing opinions, is due to the fact that enterprise as an economic form was so radically transfigured by the twenty-eight humble followers of Owen in 1844 that "a cooperative enterprise" became free from the most sinister element of existing economic system, viz., from profit. The supposed revolutionary socio-reformistic destiny of cooperation is thus ascribed to this very modification of the ordinary enterprise.

The following questions appear to be, therefore, the fundamental points in the theoretical analysis of the cooperative problem:

- a) whether a cooperative organization is a species of enterprise or not?
- b) if it is a modified enterprise what are its specific economic characteristics?
- c) if it is not an enterprise, what kind of economic body is it?

These questions are central in the theoretical economic analysis of the cooperative problem, since all the basic economic characteristics of cooperative organization should be reconciled with a certain and clearly stated concept of the cooperative as an economic organization. The detailed characteristics obviously ought to be consistent with the assumed economic character of a cooperative association. Thus, if the assumption of the cooperative organization as an enterprise is employed all the inherent economic traits of cooperative organization should be

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<sup>9</sup>H. Müller, "Zur Kritik der Genossenschaftsbegriffe," *Conrad's Jahrbuch*, Band 66, §55. 1923.

<sup>10</sup>In the formula of Dr. Powell the term "their own agency" is adopted instead of terms "enterprise" or "business unit." *Principles and Practice of Cooperation*, 1920, p. 4.

interpreted as the traits of a special variety of enterprise and expressed in corresponding terms. If such an assumption is found to be erroneous, or if the intrinsic features of cooperative organization are found incompatible with the cooperative as a variety of enterprise, then obviously the economic nature of the cooperative form must be reconsidered and redefined in such a way as to be consistent and not contradictory to all the intrinsic economic features of the actually existing cooperative associations.

Other starting points of discussion might be and should be chosen in sociological, political, ethical, legal or technical interpretations of cooperation, but in economic analysis the question formulated above is not only basic, it appears to be the only possible point of departure. The question whether a cooperative association is an enterprise or not, in spite of its popularity among interpreters of cooperation, is more difficult to answer than it may seem at the first glance. Its difficulty lies in the fact that it is not definitely known: (a) what is a cooperative organization and (b) what is an enterprise. Such an equation, with both quantities unknown, cannot be obviously solved before the evaluation of at least one of its parts. Since in all definitions of cooperation the concept of enterprise is used as the generic concept in relation to the conception of cooperative association, a solution of the question under discussion depends upon the clarity and exactness of this concept.

### Concept of Enterprise

The use of ambiguous terms, though probably inevitable in colloquial language, cannot have a place in scientific discourses. Meanwhile, the term "enterprise" is used by the interpreters of cooperation with the ambiguities of its colloquial usage and as such is utterly misleading. In the colloquial usage the following meanings<sup>11</sup> are attached to the term "enterprise":

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<sup>11</sup>The meanings and the synonyms listed are taken from the dictionaries: *Webster's Standard Dictionary*, 1933, p. 731, and *Funk and Wagnall's Standard Dictionary*, 1921, p. 828.

1. That which is, or is to be undertaken;
2. An attempt, or project, especially one which involves activity, courage, energy or the like;
3. A bold, arduous or hazardous attempt;
4. An important undertaking;
5. Willingness or eagerness to engage in what requires boldness, energy and the like;
6. Management;
7. That which one attempts to perform;
8. Any projected task or work upon which one sets out;
9. An undertaking, especially a bold or difficult undertaking, as the enterprise of tunnelling the Alps;
10. Scheme;
11. Essay;
12. Venture;
13. Act of engaging, or disposition to engage, in difficult undertakings;
14. Boldness;
15. Energy;
16. Invention exhibited in practical affairs, especially in business.

Thus the closest synonyms of the term enterprise in common use are - "attempt" and "undertaking." The following specific shades are given in Crabb's dictionary to make the distinctions among these three synonyms:

The idea of something set about to be completed is common to the terms - attempt, undertaking, enterprise. An attempt is less complicated than an undertaking; and that less arduous than an enterprise. Attempts are the common exertions of power for obtaining an object; and undertaking involves in it many parts and particulars which require thought and judgment; an enterprise has more that is hazardous and dangerous in it; it requires resolution. Attempts are frequently made on the lives and property of individuals; undertakings are formed for

private purposes; enterprises are commenced for some great national object.<sup>12</sup>

Thus in colloquial usage the term enterprise appears to be utterly indefinite and deceptive. It is used most commonly as a synonym of the term "attempt" (scheme, project, venture, anything hazardous, etc.) and is identified with the concept of management or confused with the idea of entrepreneurship. It is astonishing that this term is not interpreted to mean a certain economic organization. However, this is the only possible meaning of the term in the context of the formula, "cooperative organization is a form of enterprise."

### Term "Enterprise" in Economic Literature

The meanings attached to the term enterprise in colloquial language are listed above to show that this term, when used in economic literature, is just as indefinite and shifty in its meanings. For example:

1. It is used to signify any attempt,<sup>13</sup> or to mean alertness, bold initiative.<sup>14</sup>
2. It is confused with the concept of entrepreneurship<sup>15</sup> or
3. It is not clearly distinguished from the concept of management.<sup>16</sup>

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<sup>12</sup>Crabb's *English Synonyms*, p. 87.

<sup>13</sup>*The Trends of Economics*. New York, 1924, p. x.

<sup>14</sup>Speaking on the joint stock companies, A. Marshall says: "they seldom have the enterprise, the energy, the unity of purpose, and the quickness of action of a private business." *Principles*, p.604. H. R. Seager, *Introduction to Economics*. 1908, p. 143.

<sup>15</sup>R. T. Bye, *Principles*. 1924, p. 142. E. R. A. Seligman, *Principles*. 1905, pp. 281, 320.

<sup>16</sup>A. Marshall, *Principles*, p. 74; H. R. Seager, *Introduction to Economics*. New York, 1908, p. 143.

4. It is used "to refer to the part of the business involved in turning out each separate product"<sup>17</sup> and
5. It is also used to designate "businesses as a whole."<sup>18</sup>

Only the last interpretation of the term is consistent with the context of formulas defining a cooperative organization. Only in this sense with strict elimination of all its other shades of meaning will the term enterprise be used in this study. It is almost inexplicable that the concept of enterprise thus interpreted is avoided in economic literature. The term enterprise in this sense is seldom mentioned in the recognized *Principles of Economics* and excepting very rare remarks scattered through economic literature, has never been thoroughly defined. From this point of view it is highly symptomatic that reference to enterprise is omitted in such standard publications of reference as *Palgrave's Dictionary*, *Encyclopedia Britannica* or in the recently published *Encyclopedia of Social Sciences*.

The conception of enterprise is the cornerstone of the theoretical system of Herbert J. Davenport, yet in his *Economics of Enterprise* he made his notable definition of economics and left the conception of enterprise undefined.

Besides using the term enterprise loosely, there is undoubtedly a considerable uncertainty as to the exact and proper meaning of the concept of enterprise as an economic organization. It appears that the conception of enterprise is somewhat underdeveloped as is demonstrated by Prof. Robert Liefmann, one of the few economists who has attempted to define this conception.

In 1913 in his book *Die Unternehmungsformen*<sup>19</sup> he made the following definition of enterprise: "An organization engaged in production of stocks of goods for a market is an enterprise." Ten years later, in the third edition of the same book, he remarked that though he

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<sup>17</sup>J. D. Black, *Production Economics*. 1926, p. 204.

<sup>18</sup>*Ibid.*, p. 205.

<sup>19</sup>R. Liefmann, *Die Unternehmungsformen*. 1923, p. 5.

still finds this formula correct it is not, in his opinion, sufficient: not every economic organization producing alienable goods is an enterprise but only those organizations which are based "on calculation of their capital."<sup>20</sup> Thus he changed radically his first conception of enterprise covering all the organizations producing for a market and limited the concept to covering only the so-called capitalistic enterprises. "A small acquirer," he comments, "such as a peasant does not make any calculation of his capital; his own labor and that of the members of his family play such an important role for him, that he does not consider the means of production employed in his economy as capital; he is interested only in calculation of his profits and losses and not in his balance-sheet. All the large acquisitive economies, on the contrary, set out from a definite capital and its potential accrument: they are enterprises."<sup>21</sup>

It is obvious that the new formula of R. Liefmann is not simply a more exact form of his first definition of enterprise, but a radical change of the conception itself.

More comprehensive appears to be the old definition of enterprise proposed by Gustav Schmoller:

Where single persons, families or collective personalities invest and employ their capital and labor in accordance with the existing customs and laws in some lasting organization with the purpose of acquiring a profit through purchases and sales for their living expenses or at least for covering of their costs, there we speak of an enterprise.<sup>22</sup>

Thus interpreted the conception substantially differs from Liefmann's idea of enterprise - it embraces the whole range of existing

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<sup>20</sup>Ibid.

<sup>21</sup>Ibid., pp. 5-6.

<sup>22</sup>Gustav Schmoller, *Grundriss der allgemeinen Volkswirtschaftslehre*. 1900, Part I, p. 413.

acquisitive economies including those based "on the calculation of their capital" (Liefmann) as one of the sub-groups of enterprises.

The conception of enterprise as delineated by Schmoller:

- a) relates exclusively to acquisitive economic organizations, and
- b) embraces their whole, almost infinitely wide, range.

For the purposes of this study, the definition of Schmoller needs to be somewhat explored:

- 1) to reveal certain cardinal economic characteristics inherent in every enterprise which are implicitly assumed by Schmoller's formula, or at least are perfectly consistent with this formula, and to underline them with necessary and justifiable emphasis,
- 2) to tie up the conception of enterprise with the closely related and logically inseparable concept of household, and combine them into one organic totality, and
- 3) to find some common denominator for all the infinite diversity of enterprises and households as they actually exist, thus overcoming the confusing disarray of opinions and interpretations in regard to these economic organizations.

It leads us to a discussion of the concept of the economic individual or economic unit, a generic conception covering enterprises and households.

### **Concept of Economic Unit (Economic Individual) as the Basic Economic Concept**

If "the competitive economy is an exchange economy and, therefore a price economy,"<sup>23</sup> it also is an individualistic economy, in the sense that a society is dissociated into separate economic bodies or

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<sup>23</sup>Herbert J. Davenport, *Economics of Enterprise*. New York, 1916, p. 31.

economic individualities functioning under the competitive price regime.<sup>24</sup> There is, therefore, a complete tautology in these designations of the same object from three different angles and the conceptions are but corollaries of each other.

If a price "is the central and pivotal fact"<sup>25</sup> in the existing economic system as its basic functional characteristic, the concept of economic individual or economic unit is obviously just as cardinal a structural attribute of such system: the economic units are the subjects of all "the wealth-getting and wealth-using activities of men" (Ely) in the existing economic order.<sup>26</sup>

It is not an easy task to make the general definition of the conception of economic unit: the economic conceptions may be examined from different angles and, therefore, may be defined in many different ways; it is understood that all such definitions relate to the same concept contemplated from the different points of view and do not distort or change this concept. The conception of economic unit as it is employed in this study is almost of boundless coverage and, therefore, can be described only by a few and general economic characteristics, each accompanied by numerous implications often indefinite and variously interpreted by the representatives of the different lines of approach to the problems of theoretical economics. The concept of economic unit is so wide indeed that it is very close in fact to a group of logical categories (such as substance, quantity, quality, relation, etc.) which because of their all-embracing coverage are actually undefinable.

The following features appear to be the most salient general characteristics of economic units:

- a) An economic unit is a separate economic identity, an economic monad; it is clearly distinguishable from its

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<sup>24</sup>Prof. A. Amonn, *Grundzuge der Volkswohlslehre*. 1926, §46.

<sup>25</sup>H. Davenport, p. 28.

<sup>26</sup>An assumption of competitive exchange economic system is the fundamental economic postulate of analysis of the cooperative problem in this study.

- economic environment and is living and functioning within the economic world as the distinct economic body;
- b) An economic unit to be capable of individual economic functioning must be a completed economic body;
- c) An economic unit thus contemplated and interpreted is inconceivable without definite and far-reaching integration of its component parts; an economic unit is necessarily the economic whole.

With these general preliminary remarks an economic unit or economic individual may be defined as follows:

An economic unit or economic individual is an economic body admittedly complete and sufficiently integrated for individual existence and independent (in conditions of exchange economy - interdependent) economic functioning.

### **Economic Individuals and Physical Persons**

It appears to be self-evident that an economic individual is not necessarily a physical individual: in fact, these two cases rarely coincide. The most common case of an economic individual is a family unit. Collective economic individuals are numerous and increasingly important in existing conditions and some of them are of gigantic proportions (some stock corporations, communes, municipal units, stock economic units, etc.).

It is of importance to point out that all physical persons in their economic activities bear a sign of their relation to or their connection with some economic unit; they are either entrepreneurs, wage earners, creditors, debtors, renters, tenants, householders or members of some household, etc. The entire economic behavior of single persons is defined by such relationship with the economic units. Outside of economic units nothing "economic" can or does exist and physical persons disconnected from economic units are not conceivable by the economist.

The existing exchange economic is thought to represent a system of interdependent economic units in contradistinction to a society based

on self-sufficiency with its isolated and perfectly independent economic units or to a socialistic society as one economic unit not dissociated into any economic separateness.<sup>27</sup>

All economic activities of getting wealth and of using wealth in existing conditions are the activities of economic units which may be contemplated and examined in two principal aspects: in the aspects of their acquisitive (getting wealth) and of their spending (using wealth) functioning.

Within the existing exchange economic system an economic unit in its acquisitive aspect represents an enterprise and in its spending or wealth-using aspect represents a household.

Thus defined, the concept of enterprise seems to be perfectly consistent with the definition of G. Schmoller and, outlined purposely with such wide bounds, underlies the theoretical system of H. Davenport.<sup>28</sup>

There are certain obvious advantages in interpreting enterprises and households in terms of economic units. It helps to disclose some of their intrinsic economic characteristics. Thus it ties the enterprises and households into one logical whole. Actually, acquisitive and spending functions are combined in economic individuals, and their correlations in economic units give firm ground for the classification of these units and for orientation in the almost infinite variety of existing economic formations. The concept of economic unit in its two aspects is further important as a common denominator for all existing economic organizations which may be contemplated either as economic units, their fractions or their higher derived formations. In this very sense this conception is of exceptional importance in a study of cooperative organizations. With the concepts of enterprise and of household thus interpreted, and,

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<sup>27</sup>Prof. Peter von Struve, "Osnovnyia Ponatia Ekonomitscheskoi Nauki" ("Fundamental Concepts of Economic Science", *Ekonomichesky Vestnik*, Vol. II. Berlin, 1923, pp. 3-17.

<sup>28</sup>H. Davenport, *Economics of Enterprise*. Particularly pp. 28-29 and 138-139.

therefore, covering the entire field of economic reality, economics may be defined as a science of enterprises and households. This is identical in its meaning with Davenport's definition of this science: his formula is put here only in morphological terms.

### Fundamental Economic Characteristics of Enterprise

The chief economic features of enterprise as they are pointed out or implicitly assumed by G. Schmoller, or as they may be deduced from an interpretation of enterprise as an acquisitive economic unit, therefore, are as follows:

- a) an enterprise is an economic formation of a competitive exchange economic system;
- b) enterprises may be either individual (one person or family) or collective ("collective personalities" of Schmoller's formula) acquisitive units;
- c) an enterprise is an acquisitive organization designed to realize an income in form of residue between the prices paid for goods and services purchased or otherwise absorbed and the prices received for goods and services sold or otherwise alienated; in other words a profit is the only possible form of income in enterprise;
- d) the income of an enterprise being residual may be positive (profit) or negative (loss), but enterprises that continue to function without positive incomes are doomed to disappear sooner or later and are inconceivable as permanent acquisitive organizations;<sup>29</sup>
- e) every enterprise, being an acquisitive economic unit,
  1. strives toward maintenance of its economic individuality and of its independent economic functioning;

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<sup>29</sup>Prof. Eugen Philippovitch, *Gründriss der politischen Oekonomie*. 1915, §46.

2. has necessarily its own single acquisitive (entrepreneurial) plan;<sup>30</sup> an enterprise is literally a planned economy;<sup>31</sup>
3. is always an integrated economic body with all its component parts functioning as the integral parts of the body and in this sense strictly subordinated to the whole;
4. is characterized by the centripetal forces which are always at work in every normal enterprise and which maintain its integrity and its acquisitive functioning.

### General Characteristics of Household

Enterprises and households being economic units in different aspects are bilaterally symmetrical like the two halves of an animal body: every household represents an economic unit in its spending (wealth-using) aspect:

- a) Households, like enterprises, are individual (one person or family) or collective unities;
- b) Being economic units, households, like enterprises, are characterized -
  1. by inclination to maintain their individuality;
  2. by their plan of economic functioning (budget),<sup>32</sup> and
  3. by strict integration of all parts within the household.

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<sup>30</sup>Prof. F. von Gottl-Ottlilienfeld, *Bedarf und Deckung*. 1928, §§12-13.

<sup>31</sup>Hence the idea of a "Five Years Plan" in the Soviet Union supposedly a socialistic state, i.e., the state transformed into one economic unit.

<sup>32</sup>Abundant materials on the budgets of households in the United States might be found in several Reports prepared by the National Resources Committee ("Consumer Income in the U.S.," 1938; "Consumer Expenditure in the U.S.," 1939; "The Consumer Spends His Income," 1939) and by the Bureau of Labor Statistics, U.S. Department of Labor (Bulletins No. 642, 643, 644, 645, 646, 647, 648 and 649 published in 1939-1940). These studies are based on the data gathered in 195-1936 in the country-wide survey of budgets made by the Urban Study Consumer Purchases.

Stating these traits of similarity between enterprises and households we do not overlook the fact that the households are generally less rational and less rationally than are enterprises.

- c) While an enterprise as an acquisitive economic unit is inconceivable without profit as its specific form of income, a household as a spending unit is inconsistent with any acquisition or any form of income. That such "pure" type of household is exceptionally rare<sup>33</sup> is obvious: normally, some acquisitive (productive) functions are not completely eliminated from householding. Such functions as home baking, kitchen work, laundry, repairs, and generally the whole sphere of domestic services are distinctly acquisitive and in the interests of clarity of the concept should be regarded as an acquisitive admixture of householding. In rural households such admixtures are usually greater than in the urban units, and the same is true with regard to agricultural countries in comparison with the industrial countries. But even in the most advanced industrial countries some important branches of industry still remain in their phase of formation and cannot absorb completely their corresponding activities from the households: the commercial laundries, the baking industry, the restaurants, etc., belong to this group. In all cases where such acquisitive elements within wealth-spending economic units are subsidiary and secondary in importance in the general framework of the units and where the motives of wealth-

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<sup>33</sup>It is not a *reduction ad absurdum* of the logical category of household here employed for orientation among the actually existing variants of households. The concept of household thus understood is similar in that respect to the universally accepted conceptions used in Chemistry, which is exact science: the chemists use, for instance, a concept of water described by the symbol  $H_2O$ , being fully aware that actually a "water" represents a wide range of solutions and that an absolutely pure water cannot be prepared. But even if it could be prepared it would differ from the standard conception since it would be partly dissociated and dissociated water is not a "water" in the strict sense of the word and cannot be described by the symbol  $H_2O$ .

spending decisively predominate and define the economic behaviour or organization, we will refer to households.

### Types of Cooperative Organizations

With the concepts of enterprise and of household thus stated for consistent use throughout this study, we are now in a position to start the analysis of the cooperative problem, or at least to decipher the most important and most widely accepted thesis of the interpreters of this problem, that a cooperative organization is an enterprise. The first task in such an analysis, obviously, is to state the object of analysis, i.e., to fix our conception of cooperative organization. It has been shown in the first part of this study that opinions on what the true cooperative organization really is differ, vary and contradict each other. At this stage of discussion, therefore, we cannot fix precisely the object of our analysis, but we can overcome such a methodological impediment by a tentative and conventional outline of a cooperative type of economic organization, according to prevailing opinions among the students of this problem. According to prevailing opinions, there are two types of economic organization toward which all the existing cooperatives are tending, namely:

- a) Non-stock, non-profit cooperative associations, and
- b) Cooperatives of the Rochdale pattern (capital stock associations).

It is highly significant and symptomatic of our state of knowledge of this subject that these two conceptions of a cooperative organization are descriptive rather than analytical, and are usually discussed separately in economic literature, without any attempt at synthesis of the general idea of cooperative economic form underlying both groups. In the words of Prof. F. von Wieser, for instance, the cooperatives "carry out either the purely cooperative idea or combine it with that of the stock company."<sup>34</sup> His remark on the cooperatives carrying out "the purely cooperative idea" – indefinite as it is – relates obviously to the associations of non-stock, non-profit type. Such an emphasis on the purely cooperative nature of non-profit associations

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<sup>34</sup>F. von Wieser, *Social Economics*. New York, 1927, p. 326.

implies an assumption that the Rochdale type of association is not the purely cooperative type; this statement is in surprising contradiction to a thesis of Sidney and Beatrice Webb,<sup>35</sup> who are of the opinion that the consumers' cooperatives - all without exception the capital stock associations of the Rochdale pattern - are the only true cooperatives. These two types of cooperative organizations embrace the whole range of associations usually interpreted as cooperative, and we have no other way of approach to the problem than to examine both types separately, in order to find out what kind of enterprise, if any, they represent.

### Non-Stock, Non-Profit Association As an Enterprise

This type of cooperative association was initiated in Germany by F. Raiffeisen: in 1869 in the Rheinisch village, Heddesdorf, was organized Raiffeisen's first Darlehnskasse (rural bank) without any capital stock. Such "Raiffeisen's associations" spread gradually in many agricultural countries, and at present they represent probably the most numerous group of cooperative associations. True, the initial pattern of rural bank has later been somewhat modified by Raiffeisen. After a long struggle with Dr. J. Schultze-Delitzsch, originator of the "popular banks," Raiffeisen introduced the small-shares feature according to the requirements of the Reich's law on cooperative associations initiated by Dr. Schultze (1876). Later, cooperatives without capital stock, or at least without any dividends payable on stock, developed in other lines of economic activities in Germany, and in many other countries including the United States of America. Many cooperative dairies and bacon factories in the Scandinavian countries have no capital stock of any kind and start their work with long-term loans which are repaid by the membership proportionally to the volume of business done by each member. Many marketing cooperative associations in this country, including the famous California Fruit Growers' Exchange, the irrigation cooperative societies, the cow-testing associations, the livestock breeders' societies, the cooperative insurance associations and others, do not pay any dividends on "capital stock." Generally speaking, the cooperatives of the "non-stock, non-profit" type play an outstanding and increasingly important role in the modern cooperative movement.

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<sup>35</sup>B. & B. Webb, *The Consumer's Cooperative Movement*. 1921, p. viii.

### Elements of Enterprise in Non-Stock, Non-profit Cooperative Associations

The conception of enterprise as it has been previously outlined is characterized by the following fundamental and irrevocable feature: an enterprise is an acquisitive economic unit. Acquisition is the primary economic function of enterprise thus interpreted, just as spending (consumption) is the basic economic function of a household. The idea of an enterprise which does not acquire is illogical, just as is the assumption of a household which does not spend (consume), or of salt which is not salty, or of light which does not shine. All such assumptions combine two ideas which eliminate each other.

A non-stock, non-profit association is explicitly a (non-profit) non-acquisitive economic body, i.e., is not an enterprise. One of the most significant characteristics of a true cooperative association, the cardinal rule of a truly cooperative work, and one of the indisputable dogmas of the traditional philosophy is the principle of services at cost. The only possible form of income which can be realized by an enterprise as such on the other hand is a residual entrepreneurial income (profit). The groups of cooperative associations under discussion are designed to eliminate this very kind of income (non-profit associations). Not only profit is eliminated in principle in these associations, but any possibility of entrepreneurial income is absolutely incompatible with the cooperatives of this pattern.

It is one of the strong convictions among cooperators that only the members should be allowed to participate in economic activities of cooperative associations; if participation of outsiders is permitted in some bona fide cooperatives these outsiders are entitled to all the privileges and advantages of regular members, including the right to receive patronage dividends, distributed proportionally to the volume of economic participation in activities of the association by the members. In many groups of cooperatives of the non-stock, non-profit type, any business dealings with outsiders are actually impossible. With the economic activities limited to dealings with their members only, the cooperative associations have as their sole source for earning any profits the business transactions of their members. The members of the cooperative credit associations, for instance, have no other way to accrue any surpluses but through increased rate of interest payable by

themselves on the loans. Such a procedure of profit seeking would be obviously utterly absurd. Many non-profit cooperatives cannot have any surpluses because they have no other receipts from their members except the prorated payments covering actual current expenses of the association. For example, the salary of the manager and some other small office expenses are the only current outlays of a cow-testing association, a typically non-stock, non-profit cooperative, and they are covered by the payments of members proportionately to the number of their cows under the control of the association. The association has no other receipts of expenses of any kind and all the economic gains from the work of association membership accrue directly at the farms of the participants. A still more convincing illustration of the inconsistency of the non-profit cooperative association with any entrepreneurial income is found in the cooperative fire insurance associations. This type of cooperative association is relatively very old, is well established and widespread in many countries of Europe and in the United States. There are about two thousand farmers' cooperative fire insurance societies in active operation in this country, which carry risks amounting to more than \$10,000,000,000<sup>36</sup> or about fifty percent of the insurance in force on farm property. A great majority of such associations operate in only one county or a part of a county; a few limit their work to a single township, while some operate in several contiguous counties, or even cover an entire state. Usually such insurance cooperative associations are organized as corporations without capital stock. All the policy holders of such associations are members and only the policy holders are entitled to be members. A great majority of such associations operate under the assessment plan: if loss from fire occurs, it is pro-rated among the members, in accordance with the insurance in force. To make settlements, the Board of Directors usually borrows the money, loans being repaid when assessment is collected. Some associations make annual assessments and keep certain funds or even accumulate reserves with which they can cover losses without borrowing and without sudden increases in assessments in case of extraordinary losses from fire. From this general outline of the organization and functioning of cooperative fire insurance associations, it is obvious that they do not pursue any acquisitive aims and that every possibility of entrepreneurial in (profit-

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<sup>36</sup>V. N. Valgren, *Problems and Trends in Farmers' Mutual Fire Insurance*, Farm Credit Administration Bull. No. 23. Washington, 1938, p. iii.

loss) is inconsistent with their economic nature. Many other cooperative organizations (such as Raiffeisen's cooperative credit associations, the livestock insurance societies, the cooperative telephone associations, the livestock breeders' cooperative associations, the farmers' automobile insurance societies, the irrigation cooperative associations, etc.) belong to this group of economic bodies designed to offer their economic services to their members only and therefore are strictly debarred from any entrepreneurial acquisitive aspirations of their own. All the cooperatives of this pattern, not being designed for entrepreneurial acquisition, deprived explicitly of any sources of entrepreneurial profit, cannot be considered as enterprises, i.e., acquisitive economic units.

### **Possibilities of Entrepreneurial Income in Some Groups of Non-Stock, Non-Profit Associations**

In some groups of cooperative associations under discussion, a possibility of acquisitive activities may easily appear in practice. This is particularly true with regard to the marketing and purchasing cooperatives. The most usual possibility of entrepreneurial acquisition in such associations is in potential dealings with patrons who are not members of the association. In practice, the existing cooperative marketing and purchasing associations most frequently yield to this very temptation of gains through their transactions with outsiders. Obviously, when such acquisitive practices appear and develop to substantial proportions of the total business of the association, such association is well on its way toward becoming an acquisitive economic unit, i.e., toward enterprise. The fact that the profit accruing from such transactions in the association is not distributed in the form of dividends on stock among its members, but is received by the membership in the form of "patronage dividends" does not disprove the fact that such an association, partially at least, represents a true enterprise. However, among cooperators there has always been a strong feeling that such practices are highly objectionable and have always been interpreted and with justice - by the cooperators themselves (and in many countries by law) as departing radically from cooperative principles, and leading toward pseudo-cooperation.

It is of importance, therefore, for a proper understanding of the economic nature of a cooperative organization, that the elements of enterprise appear in this organization when it begins to degenerate into a pseudo-cooperative body.

Likewise, all other fundamental economic characteristics of enterprise are not traceable in the cooperatives of the non-stock, non-profit type. Thus:

- a) There is no entrepreneurial capital in cooperative associations of this group. The associations of this pattern are explicitly organizations without any share-capital payable by their members. The special group of cooperative associations under discussion have a share-capital paid by their membership, but no dividends on stock are paid on this capital. And, what is more important, no income of any kind is possible in these associations as long as they follow the rule of exclusive patronage of their members.

An entrepreneurial stock capital represents the indispensable feature of every enterprise and its chief characteristic is that it is employed for getting entrepreneurial profit. In the later part of this study, an attempt will be made to find out what is the economic character of the stock-capital in cooperative associations of this particular group, but now we are only in a position to state that this stock-capital, not being invested for profit in the association, is not entrepreneurial capital.

- b) An entrepreneur is the subject of economic activities in enterprise. An enterprise without an entrepreneur is not a consummated economic unit and is inconceivable as a living and functioning economic body. Enterprises without entrepreneurs do not exist: a farm without a farmer is not an enterprise but is inert fragment.

Cooperative associations of the non-stock, non-profit type are economic organizations without entrepreneurs of their own, since there is no actual possibility of realizing

an entrepreneurial income (profit). True, the members of the cooperatives of this group, like the stockholders of every typical stock corporation, have their annual meetings, decide by voting the various questions of the current economic work, elect their boards of directors, approve their annual financial reports and their current budgets. Such similarity between the cooperatives of this type and a collective enterprise is highly superficial and deceptive. The members of non-profit cooperative associations are primarily the patrons of their organization; their economic interests as patrons dominate all other considerations and dictate their economic behaviour. The general meeting of the members of such associations, therefore, represents the aggregate of the patrons of the association, and not a collective entrepreneur of this association, as is the case with every regular stock company. The board of directors elected by the patrons of the cooperative is entrusted with the responsibility of serving the economic needs of the patrons of the organization and not for pursuing the acquisitive purposes like those of the collective entrepreneur of a stock company. It is plain, therefore, that the economic interests of the patrons of an association not only do not coincide with those of members of a collective entrepreneur, but, being diametrically opposite to entrepreneurial interests, are strictly inconsistent with them, since every entrepreneurial gain in cooperative association means a corresponding loss to the patrons of this association.

- c) Being deprived of any entrepreneurial capital or of any entrepreneur, a cooperative association of the non-stock, non-profit type is not in a position to bear any entrepreneurial responsibility or entrepreneurial risks. Such responsibility and risks in the cooperatives under survey are assumed directly by their member-patrons. To illustrate this, the case of cooperative dairies may be used. Some such dairies do not invest any capital of their own to start their business, but build their plants on loaned money which is repaid through - but not by - the associations by the borrowing members, proportionally to

the number of units of butter produced and sold through the association. An association itself plays solely the role of a clearing office, without other participation in the transaction. There is no principal to assume entrepreneurial responsibilities in the non-stock, non-profit associations themselves, nor are there any means for assumption of any risks.

### Capital Stock Cooperative Associations

The other chief type of cooperative associations toward which a considerable number of existing cooperatives are gravitating is a capital stock cooperative association.

According to the special study of various phases of the cooperative movement in the United States made by the Farm Credit Administration there were 10,752 farmers' marketing and purchasing cooperative organizations in this country in 1935-1936, of which 68% (7,300 associations) were capital stock cooperatives, 22% (2,375 associations) of non-stock non-profit pattern and 10% (1,077 associations) were informal non-incorporated bodies.

The table on page 61 shows that the proportion of capital stock and non-stock associations varies greatly in the different groups of associations surveyed. The cooperatives of the capital stock pattern are usually, though not necessarily, more numerous in those lines of economic activities where a considerable investment of capital is required (grain elevators, creameries, etc.), and where such capital cannot be mobilized in any other way, while the non-stock non-profit plan is better adapted to organizations where need for considerable funds is not pressing. A wide range of cooperative bodies is covered by the type of capital stock associations. The most representative and historically prominent among them is undoubtedly the cooperative store initiated by the Equitable Pioneers of Rochdale. Unlike the non-stock, non-profit cooperatives, this type of association has almost all the structural characteristics of a stock company:

Number and Percent of Farmers' Marketing and Purchasing Cooperative Associations by Commodity Type and Legal Form in the United States, 1935-1936\*

Groups of cooperative associations	Number of Associations				Percent of Associations		
	All associations	Capital stock associations**	Non-stock associations	Non-incorporated associations	Capital stock type	Non-stock type	Non-incorporated associations
<b>I. MARKETING</b>							
Misc. Cotton	17	17	—	—	100	—	—
Grain elevators	2,614	2,520	50	44	96	2	2
Creameries	1,385	1,165	192	28	84	14	2
Cotton Gins	362	283	77	2	78	21	1
Milk Marketing	240	159	70	11	66	29	5
Cheese	543	355	21	167	65	4	31
Citrus Fruits	294	127	163	4	46	56	1
Other Fruits	255	113	123	19	44	49	7
Cream shipping	56	21	18	17	38	32	30
Potatoes	105	35	54	16	34	51	15
Livestock term.	38	13	21	4	34	55	11
Nuts	49	16	29	4	33	59	8
Vegetables except potatoes	316	104	152	60	33	48	19
Misc. selling	300	86	119	95	28	40	32
Tobacco	14	4	10	—	28	72	—
Poultry	180	49	92	39	27	51	22
Cotton marketing	22	5	16	1	23	72	5
Berries	134	26	71	37	19	53	28
Livestock local	974	159	473	342	16	49	35
Milk bargaining	114	16	86	12	14	75	11
Wool marketing	139	8	67	64	6	48	46
<b>ALL MARKETING</b>	<b>8,151</b>	<b>5,281</b>	<b>1,904</b>	<b>966</b>	<b>65</b>	<b>23</b>	<b>12</b>
<b>II. PURCHASING</b>							
Petroleum products	1,057	952	92	13	90	9	1
Exchanges	396	330	52	14	83	13	4
Feed stores	490	376	100	14	77	20	3
Misc. supplies	324	245	63	16	74	19	5
Others	334	116	164	54	35	49	16
<b>ALL PURCHASING</b>	<b>2,601</b>	<b>2,019</b>	<b>471</b>	<b>111</b>	<b>73</b>	<b>23</b>	<b>4</b>
<b>ALL ASSOCIATIONS</b>	<b>10,752</b>	<b>7,300</b>	<b>2,375</b>	<b>1,077</b>	<b>68</b>	<b>22</b>	<b>10</b>

\* This table was compiled from materials contained in *A Statistical Handbook of Farmers' Cooperatives* by F. Hyre, Farm Credit Administration, Bull. 26, 1938, p. 53.

\*\* Out of 7,300 capital-stock cooperatives 5,908 associations or 81% of their total number were incorporated under cooperative laws and 1,392 or 19% under general corporation laws.

- a) a capital stock,
- b) a body of stockholders,
- c) a dividend on stocks payable to its member shareholders, and
- d) control of the association by general meetings of stockholders, by a management elected by the stockholders, etc.

However, the Equitable Pioneers of Rochdale, according to the generally accepted opinion, have the credit for the introduction of some epoch-making modifications of the regular acquisitive stock company, namely, they dethroned entrepreneurial stock capital, lowered it from its commanding position to a level of stewardship, and put it in a position of every other paid employee. They achieved it, we are told, by the adoption of the following cooperative principles:

- a) by limitation of dividends payable on shares of stock,
- b) by limitation of the number of shares which may be owned by one holder, and
- c) by replacement of the principle of voting by shares by the rule of voting by members, that is, one member - one vote.

#### **Capital Stock Cooperative Association as an Enterprise**

The external structural similarity of the cooperatives of the Rochdale type to a collective enterprise (stock company) is so complete that its economic identity has never been questioned and capital stock cooperative associations have always been loosely interpreted as a modification of the stock company. This is explicitly expressed in the

words of F. von Wieser, previously quoted,<sup>37</sup> and is admitted with emphasis by Prof. J. D. Black, when he says:

It is apparent that the capital stock cooperative is simply a modified corporation.<sup>38</sup>

Yet such an identification needs to be thoroughly examined, and because of its large importance in the analysis of cooperative problems, such examination should be done with special care and in detail.

### Conception of a Collective Enterprise

The identification of the capital stock cooperatives with stock companies is based on the assumption that this type of association represents a collective enterprise. The concept of a collective enterprise, therefore, should be defined for a comparative examination of these two types of economic organizations.

1. Both represent an economic form of a competitive exchange economy;
2. Both are economic units in an acquisitive aspect;
3. Being acquisitive units, they are designed to realize a residual entrepreneurial income (profit-loss);
4. A single entrepreneurial plan is inherent in every enterprise, individual or collective;
5. Both types of enterprise are based on the principle of absolute subordination of their parts to a plan of functioning of the acquisitive whole.

However, there are highly significant differences between individual and collective enterprises.

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<sup>37</sup>*Social Economics*. N. Y., 1927, p. 326.

<sup>38</sup>Prof. J. D. Black, *Introduction to Production Economics*. N. Y., 1926, p. 505.

Only stock companies are taken here as typical of collective enterprises, despite the fact that some elements of collective enterprise are traceable in partnerships and in joint stock companies, since only the stock companies represent fully developed and finally crystallized collective acquisitive economic units.

Thus interpreted, a collective enterprise differs from an individual enterprise in the following main economic features:

1. The entrepreneurial capital of a collective enterprise is dissociated into its parts or fractions (shares of stock); while the entrepreneurial capital of the individual enterprise remains undivided and indivisible. It is of singular importance that a collective entrepreneurial capital appears to be not composed of a plurality of capital units associated into an entrepreneurial complex of capitals but represents a single entrepreneurial capital dissociated into its fractions. This fact manifests itself - (a) in anonymity of shares of stock, while in partnerships and cooperatives they are strictly personal; (b) in transferability of shares, while in partnerships and cooperatives they cannot be transferred without consent of the organization; (c) by principle of voting by stock which is specific of collective enterprises, and (d) in principle of limited liability of single shareholders while the whole body of stockholders (corporate entrepreneur) retains an unlimited liability typical for an individual entrepreneur.
2. The entrepreneur of a collective enterprise is dissociated into its fractions (shareholders), while the entrepreneur of individual enterprise is represented either by a physical person or by a family unit.
3. The entrepreneurial income of a collective enterprise is dissociated into its fractions (dividends on stock), while it is received directly by entrepreneurs in the individual enterprises.

The implications of such far-reaching dissociation in the collective enterprises are many and very significant. These distinctions are helpful in disclosing the economic nature of cooperative associations. Hence, the necessity of preliminary careful definition of the concepts of collective entrepreneur, collective entrepreneurial capital, and entrepreneurial income.

### A Collective Entrepreneur

In the interests of pointing the concept of collective entrepreneur attention should be focused on the following essentials of this concept:

The concept of entrepreneur, as it is here employed, is understood to mean the recipient of residual income of enterprise and, therefore, the assumer of the responsibility<sup>39</sup> of independent acquisition.

The customary description of entrepreneur as a manager and assumer of the risks of business appears to be hazy and somewhat misleading. It is misleading because the management of enterprise may be performed personally by an entrepreneur (usually in individual enterprises) or may be delegated (sometimes in individual and necessarily in collective enterprises) to a salaried person or to a body of salaried persons. But entrepreneurial responsibility cannot be delegated to anybody under any conditions or in any degree. The idea of salaried entrepreneur is preposterous.

Moreover, the risks of entrepreneurship are the risks of acquisitive efforts made in anticipation of the uncertain, unknown in advance and not necessarily positive - residual income of enterprise. Entrepreneurial risks in such a restricted sense are completely covered by the term "responsibility of independent acquisition."

In individual enterprises, an entrepreneurial responsibility is borne by one physical person or by a family unit; in a collective enterprise it is borne by a plurality of physical persons, by a legal body of the holders of shares of common stock. The importance of the precise conception of such a plurality of physical persons as of one economic

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<sup>39</sup>F. M. Taylor, *Principles of Economics*. 1916, p. 21.

individuality cannot be over-emphasized, since it throws a strong light in defining the true economic role of single physical persons – the stockholders – in the structure and functioning of collective enterprises. It is but a corollary of the concept of collective enterprise as just delineated<sup>40</sup> that the single stockholders are only fractions or parts of a collective entrepreneur. Being fractions of the collective entrepreneur, they are deprived of any possibility of independent entrepreneurial functioning outside their legitimate entrepreneurial body (legitimate body of the holders of shares of common stock). Functioning in such fractional capacity they cannot have any direct contact with their enterprises, and hence act only through their entrepreneurial whole. Actually, therefore, there is the one channel of their entrepreneurial self-expression, namely, the general meetings of the holders of common stocks where the stockholders can participate in the entrepreneurial decisions covering all the questions of economic policies of their enterprise, approval of their financial reports and budgets, election of their managing bodies, etc. All such activities of a collective entrepreneur naturally take the form of entrepreneurial decisions and resolutions. A collective entrepreneur obviously can reach its decisions only by a majority vote of its fractions – stockholders. Thus, the channel of self-expression for the stockholders is narrowed to participation in decisions of their collective body through voting. Their voting, as of entrepreneurial fractions, is normally based<sup>41</sup> on the principle of proportionality of their voting power to the relative size of single fractions, i.e., it is normally voting as of the number of shares owned by each stockholder.

The concept of the collective entrepreneur<sup>42</sup> can be made perfectly clear if it is agreed that:

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<sup>40</sup>See p. 60.

<sup>41</sup>Only a general pattern appropriate to the nature of a business corporation is considered here; an examination of the deviations from this general pattern is not within the scope of this study.

<sup>42</sup>The concept of entrepreneur is delineated here for a general pattern of a collective enterprise (business corporation).

- a) it is composed of entrepreneurial fractions (stockholders),
- b) the only possible way of functioning for entrepreneurial fractions is their fractional participation in the activities of collective entrepreneurs,
- c) the only form of such fractional participation in entrepreneurial activities is the voting of stockholders at their general meetings, and
- d) such fractional voting is the voting by shares of stock owned by single stockholders.

The principle of voting by shares of stock is therefore a reflection of the economic nature of a collective entrepreneur and is a unique, specific and unmistakable economic indicator of fractional entrepreneurship. Entrepreneurial fractions cannot vote otherwise. On the other hand, where voting by shares of stock is found, this is evidence of a collective entrepreneur.

### **Collective Entrepreneur in Capital Stock Cooperative Associations**

The member stockholders of cooperative associations of the Rochdale type (capital stock associations), as it is well known, do not vote by shares of stock. One of the basic and most prominent Rochdale principles prescribes the rule "one man - one vote." The rank-and-file cooperators and all the interpreters of cooperation have always emphasized that the Equitable Pioneers made a most revolutionary discovery when they introduced the rule one man - one vote, and thereby eliminated the commanding role of capital in running business and replaced it by a democratic control in cooperative associations. This principle of voting has always been jealously guarded by cooperators<sup>43</sup>

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<sup>43</sup>Dr. E. G. Nourse makes the following interpretation of the prevailing opinions among the cooperators on this point. "The fundamental principle of 'one man, one vote' is sometimes modified so that voting is in proportion to

and usually recognized by laws as a perfect test of a truly cooperative organization. Every tendency toward voting by shares in cooperative associations has been regarded as a tendency toward so-called "pseudo-cooperation." A voting-by-man rule became gradually a dogma of traditional cooperative doctrine and is generally esteemed almost with an idolatrous admiration. Not only the tendencies toward voting by shares are - with justice - condemned as pseudo-cooperative practices, but any departures from one man - one vote rule are declared - erroneously, as it will be shown later - as leading into "quasi-cooperation."<sup>44</sup> Since voting by shares of stock is a fundamental and indispensable economic characteristic of a fractional entrepreneurship, the stockholders of the cooperatives of Rochdale pattern are obviously not entrepreneurial fractions. Not being the entrepreneurial fractions, the members of such association even gathered in a legitimate body of stockholders, cannot be recognized as that of a collective entrepreneur. It appears, therefore, that capital stock cooperative associations - if regarded as collective enterprises - are without a principal of their acquisitive activities, i.e., they have not their collective entrepreneur.

Such an inference, striking as it is, is stated here tentatively, and is to be checked by analysis of the other leading features of enterprise in the cooperative associations of Rochdale type. Such an analysis, however, proves without any shadow of doubt that this inference is conclusive.

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patronage. For example, it may be put on the number of cows or weight of milk in a dairy association, or on trees, acres, or boxes of fruit in a horticultural association. Nevertheless, the idea is tenaciously held that membership is personal and that control should be democratically apportioned, with no additional preponderance given to wealth. Not only is it argued that God has given as much brain power and ability to the man of small means as to the wealthy, but the self-respect and interest and loyalty is preserved and developed by this recognition of personal equality. In a word the cooperator believes that the case is as good for economic as for political democracy." E. G. Nourse, "Economic Philosophy of Cooperation," *The American Economic Review*. December 1922, p. 588.

<sup>44</sup>*American Cooperation*. Volume I, p. 167, Washington, 1925.

### An Income in the Capital Stock Cooperative Associations

The other chief, and, in fact, the most decisive criterion of the entrepreneurial nature of stockholdership in the cooperatives of the Rochdale type is found by an examination of the residual entrepreneurial income in this group of associations. In contradistinction to a non-profit association, the cooperatives of this group are designed explicitly to get profit and they distribute such profit among their stockholders in the form of dividends on stocks as do all other collective enterprises (stock companies).

In an analysis of the economic nature of the capital stock cooperatives, the problem of their entrepreneurial income is the central and crucial problem. Hence, the necessity that the line of attack on the solution of this problem should be carefully chosen and the economic concepts involved should be precisely defined and consistently used. This calls for a preliminary statement as to the exact meanings of the terms used in the following discussion.

#### Entrepreneurial Income (Profit-Loss)

In the words of Prof. F. H. Knight, "perhaps no term or concept in economic discussion is used with more bewildering variety of well-established meanings than profit."<sup>45</sup> Any theoretical economic interpretation of the cooperative problem can be based on but two fundamental economic concepts: the concept of enterprise is its foundation stone; its arch stone is its functional correlate - the concept of entrepreneurial income (profit-loss). For the student of the cooperative problem, therefore, it is a great impediment that in his analytical search he encounters extreme indefiniteness in the use of the term enterprise, and innumerable controversies under which a conception of profit is concealed. However, the task of the precise outline of a conception of entrepreneurial income is unavoidable in a study of

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<sup>45</sup>F. H. Knight, "Profit," *Encyclopedia of Social Sciences*, Vol. XII, pp. 480-486.

cooperation. Thus, the student of the cooperative problem is forced to enter upon the "most difficult problem or series of problems in the field of economic theory."<sup>46</sup>

The distributive shares in the existing economic system may be distinguished differently "according to the contractual arrangements, under which the proceeds are received, according to the persons receiving them, and according to the underlying functions and factors which constitute the sources of income. Thus there are -

contractual distribution,  
personal distribution and  
functional distribution."<sup>47</sup>

Prof. Clark, stating these three aspects of the problem of distribution, then points out that "the main body of economic theory has, for a long time, concerned itself with functional distribution only."<sup>48</sup> A contractual setting of the problem of distribution, however, has certain cognitive advantages of its own and is indispensable in economics interpreted as a science on enterprise and households.<sup>49</sup> For the purposes of economic analysis of the cooperative problem, this contractual aspect of distribution may be used as a reliable analytical device. With the adoption of this aspect of the distributive process, the most controversial issues of distribution can be avoided without any detriment, for the purposes of this study.

In conditions of competitive exchange economy, the enterprises represent the "knots" where the process of distribution actually takes place. A contractual setting of the problem of distribution in contrast to its functional interpretation -

<sup>46</sup>H. Davenport, *Economics of Enterprise*. 1916, p. 10.

<sup>47</sup>J. M. Clark, "Distribution," *Encyclopedia of Social Sciences*, Vol. V, p. 167.

<sup>48</sup>*Ibid.*, p. 167.

<sup>49</sup>See p. 49.

- a) places emphasis on enterprise as an economic category of large significance and not a mere passive derivative of a combination of the factors of production, while
- b) it relates the distributive shares to men and not to things (factors of production).

Two substantially different and in some sense complementary groups of recipients of distributive shares are discernable in enterprises:

- a) Entrepreneurs, and
- b) Other participants.

A general characteristic of the distributive shares of participants in the enterprises of others is that the entrepreneurs hire and employ their economic services, or the sources of economic services owned by them, and pay for such employment a definite and stipulated advance remuneration: their shares, therefore, represent entrepreneurial costs of production. All such distributive shares of participants thus are received (and paid) in the form of prices. The wage earners, the salaried persons, renters and creditors belong to this group of recipients and the wages, salaries, rent and interest are correspondingly their distributive shares, which are all price items (contractual incomes).

An entrepreneurial income is a correlate of the contractual incomes received in and through enterprises and its thorough comprehension is possible only in connection with the mechanism of formation of these incomes in a framework of enterprise. Thus, an entrepreneurial income is a residuum as between the receipts of an enterprise (prices) and its expenses (prices). An important feature of entrepreneurial income is thus that in contradistinction to the contractual incomes of participants (which are prices) an entrepreneurial income is not a price, but a difference between the prices paid and received within the enterprise. It is worthy of note that such a residual entrepreneurial income is a specific income of enterprise and is opposed to the participant's contractual incomes grouped together in a common relationship to this entrepreneurial residuum (profit-loss).

Summarily, the contractual and residual distributive shares may be characterized as follows:

- a) Contractual incomes are received in the form of prices, while a residual share precipitates in enterprise in the form of a difference between sums of prices;
- b) Contractual incomes are incomes of the participants in enterprises of others, a residual income is the specific share of an entrepreneur;
- c) Contractual incomes, being prices, are imputable to economic services (factors of production) employed, while a residual income, not being a price, is hence not imputable to any single element of enterprise, nor can it be apportioned among the elements of enterprise on any clear and objective basis;
- d) Contractual incomes, being prices, are *eo ipso* proportional to corresponding economic services (factors of production) either in terms of time units or piece units, while a residual entrepreneurial share, due to its differential nature, is not proportional in principle to any element of enterprise;
- e) All the contractual incomes, as the price items, are the stipulated shares, while an entrepreneurial share, being differential, is by its very nature unstipulable income: it is absolutely incompatible with any stipulation, however insignificant;
- f) All the contractual shares, being price items, are necessarily and inherently positive incomes, while an entrepreneurial residuum may be normally either positive (profit) or negative (loss).

In the framework of this study, we need not go into a more detailed discussion of the group of contractual incomes, and thus we may omit the controversial, and, of necessity, functional interpretation of the conceptions of wages, rent and interest. The contractual nature of these distributive shares implies that they might be – and perhaps ought to be – interpreted as special cases of the general theory of prices. One inference, however, appears to be inescapable from the contractual aspect

of the distributive process, namely, that the groups of contractual and residual shares of distribution should be theoretically examined on two entirely different planes, and cannot be regarded as simply four similar members of the traditional (functional) grouping of incomes.

It is possible that neither the contractual nor the functional interpretation of distribution taken separately is sufficient for comprehensive analysis of distribution; and an assumption that this problem ought to be analyzed stereoscopically under both angles seems to be defensible.

The contractual aspect of distribution is adopted here in an analysis of cooperative problem and will be consistently used throughout this discussion. It must be pointed out from the start that such a setting of the problem of distribution is not entirely compatible with the interpretation of profit as containing elements of contractual incomes (wages of entrepreneur for his manual work in his own enterprise or interest imputed to his entrepreneurial capital employed in his own economic unit, etc.). In spite of the complexity and controversial character of these issues, such an avoidance of imputed incomes in this study is inevitable.

To summarize the salient features of distribution with a view to arriving at the precise meaning of the terms used in the later parts of this study, the scheme of contractual incomes and residual shares is presented in the table on the following page.

### **Entrepreneurial Income in Capital Stock Cooperative Associations**

After the outline of the contractual and residual shares of distribution just made, and on the ground of this outline, we can turn to the examination of the economic character of the income realized in capital stock cooperative associations. At this step of analysis we are concerned with only one facet of the problem of income in these associations, namely, whether or not their income is an entrepreneurial income (profit-loss). In contradistinction to the non-stock, non-profit cooperatives, the cooperative associations of the Rochdale type are explicitly profit associations, and - as with every other stock company -

### Contractual and Residual Shares of Distribution in a Framework of Enterprise

TYPES  of  ENTER- PRISE	EXPENSES of ENTERPRISE					RECEIPTS of ENTERPRISE	RESIDUE of ENTERPRISE	
						PRICE ITEMS		DIFFERENCE of PRICE ITEMS
	INCOME SHARES OF PARTICI- PANTS IN ENTERPRISE OTHER THAN ENTREPRENEURS							SHARES  of
	Mana- gers	Credit- ors	Rent- ers	Wage Earn- ers	OTHER EXPENSES OF ENTER- PRISE			ENTRE- PRENEUR
1	-	-	-	-	Expenses	Receipts	RESIDUE	
2	-	-	-	Wages	Expenses	Receipts	RESIDUE	
3	-	-	Rent	Wages	Expenses	Receipts	RESIDUE	
4	-	Interest	Rent	Wages	Expenses	Receipts	RESIDUE	
5	Salary	Interest	Rent	Wages	Expenses	Receipts	RESIDUE	
STIPULATED and IMPUTABLE  EXPENSES of ENTERPRISE						STIPULATED and IMPUTABLE RECEIPTS of ENTERPRISE	INSTIPULABLE and NON- IMPUTABLE RESIDUA of ENTREPRENEUR	
POSITIVE PAYMENTS						POSITIVE  RECEIPTS	POSITIVE or NEGATIVE RESIDUA	
PROPORTIONAL						TO		
Economic goods and services employed						Economic goods and services alienated	NON- PROPOR- TIONAL TO ANY FACTOR	

they distribute their profit at the end of the business year among their stockholders proportionately to the volume of shares owned by each member stockholder of the association. Two considerations cannot be ignored in the examination of the economic nature of the profits of cooperative associations, namely:

- a) do the profits of the capital stock cooperative associations represent a real income of the associations, and
- b) are the surpluses of the capital stock cooperative associations divided among the stockholders, as the dividends on shares, really identical with the entrepreneurial profit of stock companies?

Looking for an answer to the first question, we shall bear in mind that the unwritten law of cooperative philosophy is that every true cooperative association offers its economic services to its members only; the patronage of non-members is possible in some groups of cooperative associations, such as the cooperative stores as well as in purchasing or marketing associations generally but only on the assumption that such non-member patrons are treated by the association equally with the member patrons and are, therefore, entitled to all the economic advantages (including patronage dividends) of regular members. As in all other cooperative principles this rule is all but sacred to all orthodox cooperators as traditional dogma. Any departure from it is vigorously condemned as a departure toward a so-called pseudo-cooperation. On the other side, every member of the cooperative association has to be its patron. Stockholders who do not patronize their cooperative association are not thought by the cooperators as desirable members of the association, and are suspected of having a purely capitalistic interest in getting profit on their shares of stock. This important economic characteristic (patronage) is common to both types of cooperatives - to non-stock, non-profit associations, and to the cooperatives of the Rochdale type alike. Thus designed, the cooperative associations are obviously cut off from any source of income whatever, since with patronage limited by their membership they can have cash surpluses at the end of the business year only on the account of their member patrons, whom they, in such cases, either underpay (marketing associations) or overcharge (purchasing and some other associations). Based exclusively on the patronage of their own members, the

cooperatives obviously serve only as clearing offices of their patrons and an absolute acquisitive sterility of the cooperative associations under such conditions (exclusive patronage of membership) is only a corollary of their economic structure. The singular importance of this fact in the analysis of the cooperative problem cannot be overstated.

The second question is: Can the surpluses of cooperative associations, divided among their members as a dividend on their shares, have anything in common with entrepreneurial profits distributed among the stockholders of stock companies in the form of dividends on stock? The economic identity of purely entrepreneurial dividends on stock and of dividends on stocks paid by the cooperatives to their member-stockholders has never been actually questioned and as long as a cooperative of the Rochdale type is considered as a modified stock company, there can be no ground for doubt about their identity. The cooperative modification of capitalistic collective enterprise (stock company) consisted, according to the firm belief of cooperators (and of many students of cooperation), mainly in the fact that the founders of cooperation in the interests of democratic control of economic activities have degraded capital to a role of stewardship. They have done this by the adoption of the principle of reasonable remuneration of the contributors of capital, namely, stockholders. The dividends on stock, according to one of the Rochdale Principles, shall not exceed the current rate of interest. Thus the stockholders of the capital stock associations are receiving admittedly stipulated dividends. If our definition of profit as a residual and, therefore, unstipulable income is correct, such an income - even if it were a true income - cannot be identified with profit.

It is noteworthy that such obvious inconsistency of established interpretations of the dividends on stock in capital stock cooperative associations with the concept of entrepreneurial income has been always avoided by the interpreters of cooperation and overlooked by its students. Customarily in current discussions of the economic nature of the dividends on stock attention is concentrated on the socio-reformistic implications of this trait, and we are told that it is the manifestation of democratic control and of the abolition of the commanding role of capital in cooperative associations.

A detailed examination of the economic character of the dividends on stock in cooperative associations under discussion will be made in the later part of this study.<sup>50</sup> At this stage of analysis our concern is only to find out whether they represent an entrepreneurial income (profit-loss) or not, and we come to the following conclusions:

1. That the surpluses of the capital stock associations distributed among their stockholders in the form of dividends on stock do not represent in reality a true income of these associations, and
2. That, even if they were an income of the association, they could not be an entrepreneurial income (profit-loss).

Concluding this discussion, it is in place to point out that the question of the economic nature of dividends paid on stock by the cooperatives of the Rochdale pattern appears to be a question of considerable complexity. Not being a profit nor actual income of the association, these surpluses, distributed as they are, appear to be somewhat in the nature of interestlike payments. Yet, as it will be shown later, such an assumption is only partially correct.

### Entrepreneurial Capital in the Cooperatives of the Rochdale Pattern

The capital stock of a collective enterprise (stock company) is entrepreneurial capital dissociated into its fractions, namely, anonymous transferable shares of stock. Entrepreneurial capital is capital invested in an enterprise by its owner and employed for getting a residual entrepreneurial income (profit-loss). A share of common stock of a collective enterprise, therefore, is a certificate of entrepreneurship. The conceptions of entrepreneur, of entrepreneurial income and of entrepreneurial capital are closely correlated. The examination of capital stock cooperatives previously made led us to conclude that they have not, and inherently cannot have, a collective entrepreneur nor an entrepreneurial income. Now we have to find out whether their capital

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<sup>50</sup>See Part III.

stock is economically identical with the capital stock of stock companies and, therefore, whether or not it represents the entrepreneurial capital of these associations. It has been pointed out already that the capital stock cooperatives have not and as long as they follow their cooperative principles they cannot have any entrepreneurial income. More than that, their whole economic structure is inconsistent with any acquisitive activities of the association itself. It follows, therefore, that the capital stock of the cooperative is not invested or employed for profit getting, and hence, cannot be entrepreneurial capital of this association. An examination of the payments which are received by the stockholders in the cooperatives of the Rochdale type led us to the inference that these payments are somewhat in the nature of interest.<sup>51</sup> Tentatively, we can infer that recipients of such interest-like payments are rather in the position of creditors within a cooperative association than in the position of its entrepreneurial fractions in the sense previously stated. This assumption leads to the further inference that the shares of capital stock of cooperative associations are not documents of entrepreneurship but certificates of credit. If such inference is correct, then the capital stock of cooperatives of the Rochdale type appears to be a kind of fund loaned by the members to their association as its working capital; the member stockholders of the association appear to be, therefore, closer to a position of bondholders than to that of stockholders of their association. Being a capital invested in association as a loan by its members it is naturally remunerated by interest, i.e., by a contractual income of a creditor.

These significant and paradoxical conclusions are as yet stated tentatively. Yet some other essential economic characteristics of stockholdership confirm them. As stated earlier, entrepreneurial capital of a collective enterprise is a single capital dissociated into its fractions, namely anonymous and transferable shares of stock. Without such a perfectly fused unit of entrepreneurial capital the enterprise cannot be conceived as an acquisitive unit. This is the main economic difference between (a) a collective enterprise - stock company, and (b) a partnership and joint stock company. These latter have not a single capital unit but rather many entrepreneurial capital units combined. For this reason they cannot be recognized as perfect and accomplished

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<sup>51</sup>See pp. 74-77.

acquisitive economic units. An intrinsic feature of an entrepreneurial capital-unit dissociated into its fractions is the fractional voting power of the holders of such fractions of entrepreneurial capital, i.e., voting by shares of stock. As is well known, this very kind of voting is most rigidly and uncompromisingly rejected by true cooperators. In the interests of consistency, we infer from this widely held opinion of cooperators that such irreconcilable rejection of the principle of fractional entrepreneurial voting by cooperative stockholders means that they are not entrepreneurial fractions and that their stocks are not the fractions of entrepreneurial capital. However, if the shares of stock are not the fractions of entrepreneurial capital, then this capital is not entrepreneurial capital and it is not a unit of capital (since the component parts of a unit are, of necessity, the fractions of this unit). It is a generally accepted rule that cooperators adopt equal voting or voting by man; in other words, they act in their voting not as the fractions of a dissociated unit but rather as equal component elements of some economic plurality in which they are associated. The body of stockholders of the cooperative of the Rochdale type, in particular, appear to be a plurality of the creditors of their association and - let it not be overlooked - a plurality of its patrons.

### **Principle of Entrepreneurial Integrity in Cooperative Associations**

Cooperative organizations thus are completely deprived of an entrepreneur (a principal in the acquisitive activities of enterprise), or entrepreneurial capital (a means of entrepreneurial acquisition) and of entrepreneurial income (a cardinal criterion of the economic nature of enterprise). It is hardly superfluous here to add that all other economic characteristics of enterprise are also not to be found in and are strictly inconsistent with a cooperative type of economic organization. One of these features deserves special mention.

Every normal enterprise is based on and maintains its acquisitive integrity: all its component elements function always as its integral working parts only without any traces of independent economic policies of their own; an enterprise or acquisitive economic unit by its very nature is the totalitarian economic body and an entrepreneurial

subordination of all its component parts is its most salient and ontological characteristic.

From the days of Fourier, cooperators stubbornly insist that their cooperatives are voluntary organizations and they proudly emphasize that the cooperative association is a democratic body inconsistent with any dictatorship. If the criterion of voluntariness<sup>52</sup> has any interpretative meaning it can mean only the irreconcilable antagonism of cooperators against any kind of dictatorial tendencies of their association over their entrepreneurial independence and individuality. On the contrary the cooperative with all its business facilities serves as a working part of associated economic units of its members: it does not dictate anything to its members - its own economic policies are dictated by the associated enterprises (or households) of its members. This fundamental truth of the economic character of cooperative organization finds its most impressive manifestation in the widespread and favorite motto of cooperators themselves; "Our purpose," they say, "is not to dominate, but to serve."

Indeed there is no traceable sign of entrepreneurial integrity in cooperative associations nor any indication of entrepreneurial subordination of the economic units of members by these associations: these irrevocable characteristics of every enterprise are strictly incompatible with cooperative character of organization.

### Summary

This analytical comparative survey of cooperative associations is motivated by one definite and narrow purpose, namely, to find out whether or not cooperatives represent any kind of enterprise, as is explicitly stated or tacitly assumed without exception by all students and interpreters of cooperation.

Concluding this survey we may summarize the findings as follows:

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<sup>52</sup>See Table, p. 29.

1. This analysis has been devised to be consistently maintained on the strictly and purely economic aspect of the cooperative problem with elimination of all the technical, legal, ethical, sociological, and socio-therapeutic shades and implications.
2. The concept of enterprise, as it has been employed in this survey, is understood to mean an acquisitive economic unit within the competitive exchange economic system (after Herbert J. Davenport).
3. The conception of income adopted in this survey is interpreted in terms of contractual-residual shares of distribution.
4. With enterprise thus defined, and with profit interpreted as a residual share of distribution, the formulas: (a) a state of being enterprise, and (b) a profit getting are apparently the tautological designations of the same economic phenomenon from different (morphological and functional) angles. A residual entrepreneurial share of income (profit-loss) in such a setting of the problem appears to be the unique and specific income of enterprise and its ultimate and unmistakable criterion.
5. All other economic characteristics of enterprise and of profit used in this survey are deduced from these basic features as their corollaries.
6. The conception of cooperative association as it is used in the literature on cooperation and in economic literature, generally, is remarkably diffuse. Two empirical and customary patterns of cooperative associations were, for that reason, chosen in this survey with a view to defining the kind of enterprise - if any - these two patterns represent. Such empirical and tentative procedure may be justified by the fact that all actually existing cooperative associations are indeed centered around two empirical models:

- a) the non-stock, non-profit associations and
- b) the capital stock cooperatives.

No definite efforts have hitherto been directed to a synthesizing of these two empirical patterns into one economic concept of a cooperative type of economic organization.

7. The non-stock, non-profit cooperative associations are expressly deprived of all external structural features of collective enterprise: they have no stockholders, no capital stock nor entrepreneurial income. As long as they follow in their practice the principle of offering their economic services to their members only, and treat patron-outsiders equally with their regular membership, they remain non-acquisitive organizations. Being thus designed to be non-acquisitive economic bodies, cooperatives of this type are *eo ipso* not enterprises, as the term is used in this study.
8. A peculiar transitional group of cooperative associations<sup>53</sup> with capital stock, but with no dividends payable on stocks, are also deprived of the fundamental test of enterprise (entrepreneurial income) and therefore are not acquisitive economic units (enterprises). Their stock capital is not intended to be used for profit-getting, and therefore is not entrepreneurial capital. Their stockholders are not the recipients of profit and, therefore, are not the fractions of a collective entrepreneur. The economic position of member patrons of their association cannot be reconciled with any entrepreneurial activities of true stockholdership.
9. In sharp contrast to the groups of cooperative associations just described (paragraphs No. 7-8), the cooperatives of

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<sup>53</sup>Such as cooperative irrigation societies, cooperative livestock breeders' associations, cooperative control societies, etc.

the Rochdale type have all the external structural characteristics of collective enterprise (stock company):

- a) capital stock,
- b) a body of stockholders functioning, at first glance, exactly in the same way as the stockholders of any other stock company, and
- c) dividends payable on stocks to their every stockholder, according to the volume of shares owned by each.

The modifications which were introduced by the founders of cooperation in the regular capitalistic enterprises and which transformed them, according to widely-professed opinions, into cooperative enterprises were:

- a) limited dividends on stocks,
  - b) limited number of shares one member may own, and
  - c) limited voting power (one man - one vote principle).
10. Association surpluses, which are distributed among the stockholders of the capital stock cooperatives in the form of dividends on shares, however, do not represent an entrepreneurial income. Being limited and stipulated, they cannot be recognized for a residual income (profit-loss) and, being accrued in the association exclusively from the patronage of its own member stockholders (or of the outsiders entitled to all the economic advantages of membership), they are in no sense a real income of the association.
  11. Being thus inconsistent with the residual entrepreneurial income (due to a rule of limited dividends on stocks), and being, in fact, an inherently non-acquisitive economic organization, the typical cooperative of the Rochdale type, therefore, is not an enterprise.
  12. This statement is not disproved by an astounding similarity of the external structure of the capital stock cooperatives and that of stock companies, since all the structural features of these cooperatives are deceptive:

- a) The stockholders of these associations are not the bearers of fractional entrepreneurship (1) for they are deprived of the only possible way of functioning, which is inalienable from fractional entrepreneurship – of a fractional voting by shares of stock; (2) they are not recipients of a residual income, and (3) their position as that of exclusive patrons of the association is incompatible with their potential entrepreneurial inclinations in the same association.
- b) The stock capital of these associations being employed expressly for non-profit work is not entrepreneurial capital.<sup>54</sup>
- c) Shares of stock owned by the members of cooperative associations of Rochdale pattern do not represent an entrepreneurial capital, but due to an interestlike remuneration on the stock appear to be in the nature of capital loaned by members to or through the association;
- d) The whole history of the cooperative movement and all the achievements and failures of cooperation testify unanimously and vigorously that the principle of subordination (a foundation stone of every normal enterprise in which all the component parts of the economic unit are integrated and are functioning as the

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<sup>54</sup>It is important to note again that while entrepreneurial capital of collective economic units appears to be capital dissociated into its fractions (shares of stock) capital stock of cooperative associations represents a plurality of associated individual capitals and is similar in that respect to capital of partnerships. Hence – a) the shares of stock of the entrepreneurial capital are anonymous while shares of capital in cooperative associations are always personal and are issued only to the elected members of the association; b) the shares of entrepreneurial capital are transferable while the shares of member-cooperators can be transferred normally only with the consent of the association; c) the shares of entrepreneurial capital may be bought and owned by the individual holders without any restrictions while the volume of share capital allowed to be owned by the individual member-cooperator is limited and is maintained roughly proportional to his volume of business done through the association. More detailed examination of this subject will be found in part III of this study.

parts of the enterprise) is irreconcilable with cooperatives which are jealously voluntary organizations.

13. The cooperatives of the Rochdale type, thus not being enterprises, are covered by the legal robes of a stock company, but this customary legal form of collective enterprises, in this particular case, does not correspond to the economic nature of cooperative association.
14. Cooperative associations of all types have one essential economic characteristic in common: they all are based on the exclusive patronage<sup>55</sup> of their members. If patronage of outsiders is allowed these outsider-patrons are entitled to all the economic privileges of membership. It means that the cooperatives of all groups are inherently non-acquisitive associations. The customary distinctions between non-stock, non-profit associations and capital stock cooperatives are of legal origin. These distinctions only becloud the true economic concept of the cooperative form of organization. The true cooperative, in the economic sense, is literally and exactly a non-stock, non-profit association.

### Conclusion

The conclusion we have arrived at in this part of the study answers part of the question of Richard Pattee, the President of the American Institute of Cooperation at the First Session of this Institute. Mr. Pattee said in the Conference on the tests of cooperation:

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<sup>55</sup>The terms patronage, member-patron, etc., are not exact terms: they are not descriptive for several groups of cooperatives, such as productive associations for instance. Only because they are generally accepted terms in the literature on cooperation they are employed here. A patronage in cooperatives means an active participation of members in common work of their association; the term member-patron means member-active participant of association, etc. In this sense these terms are used in this study.

You cannot, probably, tell what it (a cooperative association) is, but you can tell to a certain degree what it is not.<sup>56</sup>

To the last part of his question, we are now in a position to answer: A cooperative association is not an enterprise (an acquisitive economic unit).

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<sup>56</sup>*American Cooperation*, Vol. I, p. 165. Washington, 1925.

## PART III

**COOPERATIVE ORGANIZATION AS AN  
AGGREGATE OF ECONOMIC UNITS  
(ENTERPRISES OR HOUSEHOLDS)**

The foregoing comparative examination of the principal empirical patterns of cooperative associations led us to the conclusion that the generally accepted interpretation of a cooperative organization as an enterprise (acquisitive economic unit) is highly misleading and erroneous because all the intrinsic economic characteristics of enterprise as an acquisitive economic unit are:

- a) untraceable in cooperatives and, what is more important,
- b) inconsistent with their economic structure.

A close analysis of the so-called "pseudo-cooperative" associations shows <sup>1</sup> further that even the slightest traces of the elements of enterprise – such for instance as a tendency toward acquisition – manifest in all cases a decomposition of the cooperative body and its degeneration into a "pseudo-cooperative formation," in other words, a strictly cooperative economic structure appears to be a kind of antithesis of enterprise.

Such a conclusion is an important milestone in the course of this inquiry, and its turning point. Since the major part of the traditional comments on cooperation is rooted in this untenable assumption, its rejection clears the way to the direct disclosure of the economic nature of cooperative organizations.

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<sup>1</sup>See below, the chapter "Pseudo-Cooperative Associations."

### Cardinal Point of Departure in Economic Analysis of Cooperative Problem

No student of cooperation can successfully attack this problem unless he makes the point of departure in his analysis the fact of singular cognitive significance that every cooperative association is composed of economic units, acquisitive (enterprises) or spending (households).

This objective fact is very plain, is not beclouded by any exceptions, and is easily verifiable. In the table of tests of true cooperation presented in the first part of this study,<sup>2</sup> nobody out of twenty-three economists quoted has made explicit this fact. Six of them, however, have pointed out that the cooperative body represents "a union of persons" (A. Anziferoff, H. Filley, Ed. Jacob, H. Kaufmann, W. Sombart, and F. Staudinger). This test being without definite economic meaning by itself diverts, nevertheless, attention from the cardinal fact that a cooperative organization is an organization of economic units, i.e., of enterprises or of households. To make clearer this statement that a cooperative consists of enterprises or of households, we can use the following simplified case. Let us assume a community of 200 families, each consisting of five persons, i.e., a community of one thousand persons. Let us further presume that every person in this community is an enthusiastic cooperator, so much so that he would not miss being a member of the cooperative if there were the slightest chance to be one. More than that - if there is any chance to organize any kind of cooperative association in this community it will be organized. In the interests of simplification we shall regard this community as an agricultural community, economically homogeneous and consisting exclusively of family economic units, both in their wealth-getting and wealth-using activities. We have, therefore, in this community 200 enterprises and 200 households. For further simplification of the case, we can regard the enterprises as strictly specialized and engaged in the following lines of economic activities:

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<sup>2</sup>See p. 29.

<u>Lines of Economic Activities</u>	<u>No. of Family Enterprises</u>
1. Grain growing	100
2. Commercial vegetables	10
3. Dairying	20
4. Fruit growing	60
5. Retail trade	5
6. Repair shops	<u>5</u>
Total	200

Taking into account the extreme enthusiasm of every member of this community for cooperation, we can foresee the following number of cooperative associations which can be organized in this community and define exactly the maximum potential number of members in each cooperative association:

<u>Kind of Cooperative</u>	<u>Maximum Potential Number of Members</u>
1. Cooperative Grain Elevator	100
2. Association for Marketing Vegetables	10
3. Association for Marketing Dairy Products	20
4. Cooperative Bull Club	20
5. Cow-Testing Association	20
6. Association for Marketing Fruits	60
7. Purchasing Association of Retailers	5
8. Purchasing Association of Shop Operators	5
9. Purchasing Association of Farmers	190
10. Cooperative Laundry	200
11. Cooperative Bakery	200
12. Cooperative Store	200

It should be distinctly understood that the number of potential members of every association mentioned is the maximum number, and any further increase of membership under the given conditions is quite impossible, since any additional person from this community cannot be an independent patron of the association; thus:

- a) the cooperative store, laundry and bakery with their respective memberships of two hundred persons representing all the house

holds of the community absorb the entire potential patronage of the community;

- b) with the family units specialized in their entrepreneurial activities only five members may organize the retailers' cooperative; all other one hundred ninety-five families are obviously not eligible to this association as being unable to patronize its work; the same is true of the association of shop keepers, and in fact of every other "cooperative association of producers" in this list (Nos. 1-9);
- c) the twenty families of dairymen can organize three different cooperative associations, yet nobody but themselves can participate in these associations.

Thus the maximum potential number of members in any of the cooperative associations listed cannot exceed the total number of economic units related to its field.

It should be also clearly borne in mind that one physical person only from every family-enterprise or family-household is normally eligible to an association's membership. This one member represents the entire potential volume of patronage of each economic unit and any additional person from the same family cannot be the real patron of this association (an association of patrons).<sup>3</sup>

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<sup>3</sup>Illustrations: One *bona fide* member of the cooperative fire insurance or irrigation association represents the entire possible volume of patronage of his family-economic unit, since any additional representative of his family has nothing to insure or irrigate; likewise, if the farmer-father is a member of the cooperative grain elevator or of the fruit marketing association his son or other member of his family cannot become a *bona fide* member of the same associations since they have nothing to sell through this association, etc.

Briefly, every cooperative association is a representative body: each member of such an association is a delegate and a spokesman for his economic unit in the cooperative.<sup>4</sup>

Considering this singularly important fact, we are compelled to admit that the interpretation of a cooperative as "a union of persons" is not only without explanatory or descriptive value, but is utterly misleading: it diverts attention from the point of cardinal significance, namely, that every cooperative organization is composed of economic units.

If every existing cooperative association is an organization of economic units (enterprises or households), i.e. if it is composed of such economic units, we are compelled to recognize that the cooperative, not being an enterprise (an acquisitive economic unit), is a derived economic formation.<sup>5</sup> We shall look, therefore, for a type of economic organization which corresponds exactly to all the peculiarities of the cooperative among the derived economic formations.

### Derived Formations of the Economic Units

The concept of an economic unit, as it has been outlined in this study,<sup>6</sup> is understood to mean an elementary economic individuality within the existing system of exchange economy. As an elementary formation it may serve as a common denominator for all other economic

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<sup>4</sup>In the actual practice of cooperative organizations the rule of one member from every economic unit in the cooperatives is overwhelmingly predominant. The incidental deviations from this rule in some groups of cooperative associations do not disprove the general pattern.

<sup>5</sup>The detailed discussion on the derived economic formations – as the term is here used – follows on pp. 91-111.

<sup>6</sup>See above, pp. 46-55.

bodies which can be spoken of in terms of economic units. The economic units thus are contemplated as being -

- a) dissociable into their component parts, economic fractions,<sup>7</sup> or
- b) associable into higher derived economic formations composed of economic units.<sup>8</sup>

At the present stage of the inquiry we are concerned mainly with the higher formations derived from the economic units.

A tendency toward economic concentration is an outstanding characteristic of modern economic life. In popular discussions of this subject, its monopolistic phase has received an amount of attention disproportionate to its real significance and somewhat detrimental to a thorough examination of the other important aspects of this movement. These aspects, however, are so significant that even if the monopolistic trend had never taken place, an extended investigation of the processes of economic integration still would be perfectly justifiable. A student of cooperation cannot avoid the problem of economic integration, since a cooperative movement is one of its important and far-reaching manifestations, but he looks at this problem from a wider angle, free from the one-sidedness of its monopolistic presumptions. One aspect of the large problem of economic integration is of special interest in a study of cooperation, namely:

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<sup>7</sup>An "economic fraction" - as the term is used here - means any part, or uncompleted group of parts of an economic unit; the basic economic characteristics of economic fractions are (a) their incompleteness for and, therefore, (b) their inability of independent economic functioning. Economic fractions dissociated from an economic unit (an employee out of employment, capital which is not used, etc.) or groups of fractions incomplete for independent functioning (a farm without a farmer, a retailer without a store, or vice versa) are economically dead. The so-called "submarginal" economic units may be interpreted as being in midway between the uncompleted economic groups of fractions and the normal economic units.

<sup>8</sup>See above, pp. 88, 90-91, and following, pp. 92-111.

- a) to trace the principal channels of economic integration, and
- b) to examine the cardinal types of derived economic formations created through these channels.

### **Principal Channels of Economic Integration**

Processes of economic integration flow through three principal channels:

- a) through an expansion of existing individual economic units,
- b) through their fusion or consolidation, or
- c) through the coordination of activities of existing economic units.

In this study we need not go into detailed discussion of the first of these lines of integration, since it cannot be expected that a cooperative organization, being a derived form of an economic unit, can find any explanation in the processes of growth of single economic units. The expanding enterprises remain naturally acquisitive economic units, while the cooperative, as has been repeatedly pointed out, is inherently a non-acquisitive formation. The other two ways of integration – a fusion of economic units and coordination of their economic functioning, on the contrary, call for detailed consideration.

### **Fusion as Process of Economic Integration**

Fusion as a process of economic integration means a complete assimilation by a newly derived economic body of the economic ingredients involved. These ingredients in the process of fusion lose their independence and their economic individuality. They cease to exist as economic entities, perfectly analogous to foods assimilated by an organism. As a process of integration, therefore, a fusion is a transformatory and a revolutionary process. It leaves nothing untouched

in the economic nature of the ingredients involved. They are assimilated without remnants and become only the depersonalized parts of a fused body. Such far-reaching economic changes are not always, nor necessarily accompanied by corresponding technical or legal changes. When the well-known independent stock companies engaged in the manufacturing of harvesting machines (McCormick, Deering, Milwaukee Companies and some others) were fused into the International Harvester Company of America about two decades ago, they were completely absorbed by the new gigantic trust and as separate enterprises have entirely disappeared; yet their factories have continued to work for a long time, probably without any visible changes, and even their individual trademarks are still in use.

In a study of the cooperative problem, our concern with the problem of economic integration through fusion of economic bodies is very distinct: we can touch this problem only insofar as it helps to find out whether or not there is a place for cooperative organizations among the products of economic fusion.

### **Products of Economic Fusion**

Two kinds of economic fusion may be discerned:

1. Fusions of the parts or fractions of economic units, and
2. Fusions of economic units.

Fusion is characteristically a process of integration of the fractions of economic units. Being inherently incapable of independent economic functioning, every economic fraction is destined to be fused into or to be absorbed by some economic unit; every economic unit - either enterprise or household - may be contemplated as a product of fusion of its integral parts. Fusion of economic units differs little from the fusion of fractions from the standpoint of the absorbing unit, but there is an essential difference from a fractional fusion for the unit which is absorbed. While for economic fractions the moment of their absorption

means a beginning of new economic life, e.g., an area of uncultivated land absorbed for economic utilization by a farm. Such a moment for an economic unit means an end of its independent economic existence. An absorbed unit disappears as a separate economic individual and becomes only a depersonalized fraction of a newly derived economic organism strictly subordinated to its general plan of economic functioning, e.g., a farm purchased by a city resident to be used as a summer residence, or an independent bakery bought by the chain grocery store company.

The new economic formation created in the process of fusion when this process is completed is always a new economic unit. A fusion of enterprises produces a new enterprise and a fusion of households leads toward the creation of a new secondary household. In connection with an analysis of the cooperative problem, the fact that fusion leads straight toward the creation of a derived economic unit is the most significant characteristic of this channel of economic derivation, since a cooperative organization, not being an economic unit, obviously cannot be a product of economic fusion.

### Partial Fusion and its Derived Products

A partial fusion, or partial consolidation<sup>9</sup> of economic units, and particularly of enterprises, is a process of exceptional prominence in modern industrial society. Though this process may be contemplated as an uncompleted fusion, it should be recognized as an independent and specific channel of economic concentration. Economic formations derived through the partial fusion of economic units represent, as a rule, stable economic bodies of considerable theoretical interest and of outstanding practical importance. Though partial fusion occurs among all types of economic units, it is represented most conspicuously by the partially consolidated stock companies. It is facilitated by the anonymity

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<sup>9</sup>L. H. Haney, *Business Organization and Combination*. 1914, pp. 131-132.

and transferability of stocks and is usually achieved through a fusion of entrepreneurial capital (common stocks) between various collective enterprises. In the vernacular, this way of economic integration is essentially and literally "a capitalistic" integration. The products of partial fusion are commonly known under the name of "combines." Their diversity is almost boundless and their socio-economic role in the processes of economic concentration is impressive, often sinister. The degree of fusion among the enterprises participating in a partial fusion naturally varies. *A priori* the ties between the semi-fused units are closer if a larger share of the entrepreneurial capital is fused among the participants. Companies may hold a small volume of common stocks of other collective enterprises for the purposes of business information only. When a considerable minority of entrepreneurial capital is owned, it offers an opportunity to influence the policies of the enterprises concerned; when a majority of stocks is absorbed it leads to "control" of the enterprises, which is in many cases identical for practical purposes with the full ownership achieved through a complete fusion. Such "control" is often accomplished in practice by the holders of an absolute minority of the shares of common stock, either because of inefficiency of the stockholders or because of the dominating influence of individual leaders or groups.

The vast complex of economic problems connected with the processes of partial fusion of economic units is treated in a considerable body of economic literature dedicated especially to this subject and their examination is far beyond the direct scope of this study. The brief consideration of partial fusion here is given for the purpose: (a) of eliminating this complicated and significant sector of derived economic formations and thus further clearing the way for the discussion of coordination as a channel of integration which is of direct and special interest to the student of cooperation, and (b) of drawing a sharp line of cleavage between cooperative associations and the "combines" of economic units originated by the process of partial fusion. All the derived economic organizations born in the processes of partial fusion remain distinctly either economic units or their modifications. The enterprises partially fused continue to be acquisitive forms; the "combines" – a specific product of partial fusion – are without exception