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SOVIET CO-OPERATIVES: A FORCE FOR MAJOR ECONOMIC DEVELOPMENT*

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EXECUTIVE SUMMARY

The Soviet Union is host to a new domestic development that is potentially of major global economic significance. This is the cooperative movement. Since late 1987 when enabling laws were issued, a cooperative is any group of three or more persons who are chartered to enter any business they propose except certain specified businesses that are prohibited. After collecting revenues from this enterprise and paying all costs and taxes the "members" are entitled to retain the profits and distribute them as they see fit.

Membership in a cooperative represents a concept of worker participation in profits, not a concept of non-worker ownership. It is in every sense of the word free enterprise and the exposure of enterprises to market forces. It represents a collective decision usually driven by a founder, to enter a business, profit from it or ultimately perhaps, to terminate it. If the concept of free enterprise flourishes further in the Soviet Union, it will most likely do so by evolving further out of cooperative concepts and not, as far as can be seen, out of some yet to be established new private channel.

Consultants of the United Nations Industrial Development Organization, in co-operation with the Association of Information and Data Processing, InformVES, and the State Committee for Science and Technology studied a certain significant portion of this cooperative movement, the production cooperatives. Certain representative types of production cooperatives, banks, construction cooperatives, and several producing a variety of products were considered the most promising to study. The five cases studied in detail have been issued as separate documents. 1/ The objective was to weigh against the experience gained elsewhere the recent history of the cooperative movement and to identify key issues for cooperatives and what actions should be taken to further maximum contribution to the Soviet economy by the cooperative route.

Major Characteristics of Cooperatives

At the end of 1987, there had been 23 cooperatives established. By mid-1989 there are an estimated 100,000 of them active, employing a total of 1,500,000 people with annual revenue rate estimated at 12 billion roubles (1 rouble equals \$1.54 at the official exchange rate). The movement has therefore grown explosively and the rate of growth is still accelerating.

These numbers exclude agricultural cooperatives. Agricultural cooperatives are distinct from collective farms and there are relatively few of them since land ownership is the prerogative of the state. Three-quarters of the cooperatives are service cooperatives, and restaurants, automobile repair shops and retail stores are the three most common kinds. But 25,000 of them are production cooperatives, i.e., ones that manufacture and sell a product or technical service. It is this sector of the industry, that was considered to be the most significant for the future and that the experts were asked to study.

The average cooperative has a small number of employees (15 on average). Production cooperatives have a similar characteristic, although some of them have grown to considerable size with several having approximately 2,000 employees. Many of them produce consumer products, although some are in fields of reasonably high technology, and the total product lines are as varied as human ingenuity would suggest.

So far production cooperatives have had a high success rate. Their high rate of revenue growth has produced a high rate of profits.

While growth has been dynamic, an overview of it should be kept in proportion: it still represents less than 1% of non-agricultural gross national product and of employment, so the movement is still small in the overall.

1/ ID/WG.498/2(SPEC.), ID/WG.498/3(SPEC.), ID/WG.498/4(SPEC.), ID/WG.498/5(SPEC.), and ID/WG.498/6(SPEC.).

Key Issues: Operations

In order to understand the key issues facing cooperatives, there needs to be some description of operating constraints. In general, daily operation both for cooperatives and state-owned enterprises (SOEs) alike is difficult: industry operates in a climate of central planning that works increasingly less well with the passage of time, with chronic shortages, and a network of inhibiting controls and regulations. As a result, industrial operations are characterized by daily improvisation, erratic production flow, productivity well below human potential, and preoccupation with prescribed, often irrelevant production quotas.

While this is true of all industry, there are additional constraints on production cooperatives that require special description. It is these that give rise to the justifiable cooperative complaint that vis à vis the state-owned enterprises, they do not operate from a "level playing field":

Varying methods of operation and sponsorship. There is significance in the separate historical origin of production cooperatives. Whereas it is assumed that most service cooperatives were started up from nothing, many of the production cooperatives, including sizeable ones and probably a majority of them, were "spun off" from having been a department of a state-owned enterprise. As a result, most of these retain a symbiotic relationship with their former parent without which they would have much more difficulty flourishing. The balance of the production cooperatives were started up de novo by their founders in response to their perception of a market opportunity.

Raw material and Cost Mark-up. The major day-to-day operating difficulty of a cooperative is the shortage of raw materials, components, and equipment. Such advantages as a state-owned enterprise has by being a participant in the supplies quota and allocation system can be passed along to some extent to an associated cooperative where this relationship exists. Procurement is accomplished by constant scrambling, stockpiling and barter. That cooperatives are able to operate effectively under such hand-to-mouth conditions is a tribute to their ingenuity, motivation and inherent entrepreneurial ability.

Once materials and equipment are assembled, the cooperative sometimes, but not always, has another unique hurdle to overcome. Some cooperatives must pay the Government a multiplier on their material cost of 3 to 6 times the initial state-mandated price at which SOEs purchase. This functions as a hidden discriminatory tax on cooperatives, designed to compensate roughly for the mark-up imposed on state enterprises when they transfer to state distribution agencies at a marked up price.

Credit. Rapid revenue growth customarily requires of necessity heavy amounts of cash to finance growth. In the Soviet Union, this has not been the problem that might have been expected. A typical high profit rate for cooperatives is one of the reasons.

The practice, unusual in the world at large, especially in government-controlled economies, of very prompt payment is another reason. The absence of the concept of "dividends," rights of "owners" as distinguished from workers, is another contributing factor.

However, credit is still short in many cases due to State priorities taking precedent, but it is becoming more available to cooperatives through an increasingly responsive banking system. Furthermore, this situation is further improving due to the growth of cooperative banks, one of whose stated missions is to provide priority financing to cooperative enterprises. The growth of the cooperative banks is one of the bright spots in the cooperative system.

Lease assurance. Private ownership of land does not exist in the Soviet Union. Private ownership of buildings and expensive equipment is permitted but rare. A much more common mode of employing fixed assets is by lease. In fact, the creation of lease obligation is an important part of the actual contractual creation of a cooperative. Most leases are not true

term obligations. Either they operate at the day-to-day pleasure of the lessor or there are inadequate protections against cancellation. This could become a future problem. Perhaps surprisingly, cooperative managers do not see this as a current problem, but most probably as the need for reinvestment to fuel growth becomes increasingly pressing, cooperative entrepreneurs will want term lease assurance in order to have reasonable expectations of a return on their investment. It is recommended that term leases with some protection against violation of the terms be introduced on a wider scale.

Productivity. It is quite common for pay in production cooperatives to be much higher than it is in comparable state-owned enterprises. Furthermore, there is convincing evidence that output per man is greater in cooperatives. Calculations indicate that productivity in a production cooperative has to be at least double what it is in a state-owned enterprise. This increased productivity is another of the bright spots of the cooperative movement and a justification in itself for further encouragement of cooperatives. It is this productivity factor that overcomes and compensates for many of the other disadvantages under which cooperatives operate.

Pricing. Cooperatives are a minority participant in the state-controlled economy and they are subject to the same control of input costs and output prices that their state-owned competitors are. Experience elsewhere has shown that for entrepreneurship to flourish fully, it must ultimately be relieved of these controls. In the meantime, with due regard to being careful about mounting inflation in the Soviet Union, it is recommended that cooperatives be gradually cut in on the allocation system and gradually relieved of price controls so that the full benefits of market orientation can operate.

Key issues: Governmental

The above constraints are all ones that are imposed primarily on day-to-day operations. In addition to the constraints of pricing (which is after all government imposed), there are certain other practices by which the Government imposes other severe constraints on cooperatives:

Taxation. The perception of almost 100% of production cooperative managers is that the major immediate problem they face is one of taxation. Taxes on a cooperative are not levied as taxes on income, but are value added taxes, quite comparable to the VAT taxes common in Western Europe in that they are levied only on valued-added, i.e., revenue minus material input. Tax rates have up until July 1, 1989, been relatively low, ranging from 2% to 10%. The new tax decrees that will be effective raise the statutory rate to 5% to 60% with the general expectation as further described below, that the tax rates for production cooperatives will be around 30%. Such a rate would seem to border on being confiscatory.

There is no such thing as a "policy-neutral" tax. Every tax has the result of encouraging or discouraging some economic development and most taxes are consciously designed to do one or the other. Furthermore, it is quite common for Governments to try to nurture infant economic activity by every kind of encouragement, importantly including tax concession. While the Soviet Union may have some reservations about some of the excesses of the cooperative movement, it clearly wants and should want to encourage growth of cooperatives. Infant industry growth is not encouraged by increasing the tax burden to the maximum that a Government thinks the infant can stand. Therefore the Soviet Union should be encouraging the cooperative movement by a carefully designed, cut-to-measure tax policy, not by tripling or more than tripling taxes on cooperative revenues less than two years after their creation.

Decentralized local government control of cooperatives. In most cases, the chartering entity for a cooperative is the local soviet, i.e., the municipal council, as opposed to the national or republic governments. The mere fact that there is a governing charter document gives each of these local governing bodies substantial control over the cooperative. Furthermore, this control is widely discretionary. The tax law furthers this trend by setting up a wide range of tax rates with only very broad guidelines as to application, thereby allowing wide latitude to the local soviets in setting the actual taxes.

This trend to decentralization is an essential part of today's Soviet Union. It could not be reversed for cooperatives or for most other sections of Government, and nobody wants to reverse it. Nevertheless, the degree of latitude is out of balance, with too much potential arbitrary power over cooperatives in the hands of the local authorities. This wide latitude can lead to intentional or unintentional economic discrimination and in its extreme, while there is no evidence that this is happening, to conscious favoritism and corruption.

A balance toward less local latitude of governance over cooperatives needs to be achieved.

Legal assurance. To strike this balance, certain elements of cooperative governance need to be strengthened at the national level. It seems that there is not enough legal protection of cooperative rights on a national basis. Cooperatives need to be encouraged by the backing of law and the assurance they have some redress from the local operating level of Government.

Key issues: Organizational

Production cooperatives basically have evolved out of the entrepreneurial drive of their cooperative founders, now Executive Directors. Curiously, it appears that in actual practice the Executive Director has fewer constraints on his decision-making and actions than does his opposite number, the head of a corporation in the West. This has been one of the contributing factors to the successful growth of cooperatives, but unchecked, problems in the future could occur. These are the problems of practical checks and balances to which the members of cooperatives are entitled and the problems of cooperative governance and succession. Therefore, there need to be some prescriptions for cooperative management spelled out in national law or at least as a standard inclusion in charters.

Some cooperatives have restrictions on the degree to which they can employ non-members in the cooperative. On examination these restrictions serve no useful purpose and are a factor that could inhibit morale. Since they are not of practical use, they should be discontinued.

Recommendations

This report spells out in detail a number of recommendations to deal with the various issues that confront cooperatives. In summary, the major recommendations are as follows:

1. Progressive and important to the economy as the cooperatives are, they are not viewed by the general public with total admiration. Instead, it views the cooperatives as pricegougers. There may be some justification to this as regards service cooperatives. The examinations of production cooperatives did not show any case of prices excessive to comparable state-owned enterprise prices. In the case of most production cooperatives, by far the largest part of their sales are in any case made to state distribution agencies at mandated prices equal to those at which state-owned enterprises transfer like products.

Experience elsewhere shows that Governments cannot and politically will not sustain support of an economic programme to which the public is generally opposed. Therefore, through its Association and otherwise, a public awareness program creating better understanding and appreciation of cooperatives is needed.

2. Tax policy needs to encourage cooperatives whereas the new tax policy discourages them. The new tax policy needs to be suspended and superseded by a tax rate schedule that is more moderate. A net tax rate of 10% to 15% but not over 25% is about right. There should be some considerable local power to modify tax rates downward to these levels but not an excessive amount of such discretion. Unified rates are needed providing a tax balance between cooperatives and state enterprises. Discriminatory taxes such as the cost mark-up should be phased out.

3. Beyond this, a balance needs to be struck between the latitude of regulatory discretion allowed the local soviets and rights of cooperatives founded in law. More national laws governing cooperatives in somewhat more detail are needed along with some narrowing of local governmental discretion. Beyond this the law, especially tax law, needs to send a positive signal and give some assurance of reliability and immunity from radical change.

4. In general terms, cooperatives need a "more level playing field," operating conditions for production cooperatives should blend them in to the economy so that they operate on equal terms with the as yet much more powerful and important state-owned enterprise sector.

The blending should be gradual over a period of time. Experience says that if dislocation is to be avoided, the removal of any one segment of an economy from pervasive governmental controls needs to be gradual if it is an isolated sector in the system. Furthermore, other experience shows that abrupt removal of controls in an economy of shortages and allocations can fuel inflation to a dangerous extent. The relatively rapid accumulation of money by people in the Soviet Union and the fact that this money has further aggravated shortages would make us apprehensive.

Beyond this and in more general terms, there is another operating balance that should be developed. A mention was made above on the symbiotic relationship that benefits many of the production cooperatives in their relationship with state-owned enterprises. Symbiosis works both ways. One would like to see a development where a profit orientation and a market orientation are introduced into the state-owned enterprises. Cooperatives are already oriented along these lines and could help lead the way.

5. A Cooperative Association is being formed in the Soviet Union right now. It will be most effective if it is a single rather than a multiple organization and if it has a strong full-time Executive Director with political influence. Views on its objectives are spelled out as to how operations, budgets and dues should be arrived at.

Future Study

From the beginning, an interesting phase 2 has been planned in this assignment. Currently scheduled for early 1990, there will be a conference to present the findings and supporting case study details to its sponsors. The conference will also include participants from invited socialist states with centrally planned economies. Wide global acquaintance with more facts about cooperatives will be helpful shared knowledge. Just as important, the publicity within the Soviet Union that should attend such a conference can be in itself a constructive event. The Soviet Union is a supply-short economy within which strong demand is accumulating to the extent this is true of other states, especially socialist, centrally planned states, these Soviet case examples should be helpful material.

A summary of this report and of pertinent cases both of Soviet cooperatives and relevant cases from elsewhere will be presented to the conference.

Conclusion

The two-year old cooperative movement is at a critical juncture in its history. On the one hand, it is enjoying such dynamic growth that it seems almost inevitable that it will further develop rapidly. On the other hand, the Government can virtually wipe out the movement if it chooses to do so by a confiscatory tax policy. One interpretation of Soviet history says this has happened twice before -- once in the late 1920s and again about 1960. Cooperatives are therefore understandably apprehensive.

Instead the Government should encourage the movement and in doing so can mold it along lines beneficial to the State and to its economy. So encouraged, the natural vitality and developing entrepreneurship of an emerging Soviet society can over time take the lead in creating major beneficial changes in the Soviet economy.

I. INTRODUCTION

This report is about economic growth and change in one of the world's major economic powers: The Soviet Union.

For years the Soviet civilian economy has stagnated, principally because it has become caught in its own web of centrally-planned overall goal setting not related to the realities of front-line operations. Worst of all, this system ignored basic business motivations to a degree that made the economy a chronic underperformer.

In late 1987, an almost unnoticed development was legitimized in law when it became legal to charter member-owned private enterprises called cooperatives (soiuz). These groups were entitled to start up or take over a business, to run it with unprecedented freedom and to own completely any resulting profits. A more complete description of these small individualistic enterprises -- cooperatives providing retail services in response to consumer needs -- is contained in the body of the report. Almost immediately another kind of cooperative developed, the production cooperative, one that made and sold a product and was therefore, however small, a true profit-oriented and market-oriented industrial enterprise and thereby a legitimized new force on the Soviet economic scene.

Given the extra-legal origins of the earliest cooperatives combined with their explosive growth, it is not surprising that this growth was somewhat uncontrolled and that excesses developed.

Now, when the movement is almost two years old, the Soviet Government faces the following questions:

- Does the cooperative movement have the vitality and strength to become a truly significant economic factor in the Soviet Union?
- Can its uniquely Soviet origin and design be built upon to create an effective, uniquely Soviet major economic instrument?
- Will the movement survive; can the Soviet Government help it to do so to the country's major economic benefit?

The answer to all these questions can be "Yes" if the Soviet Government will identify the key issues affecting the cooperatives' future and if it deals with them constructively.

This report tells the story of the production cooperatives. It is designed to help identify these key issues in the cooperatives' future and recommend constructive measures to be taken now that will realize the movement's full economic potential.

II. SOVIET PRODUCTION COOPERATIVES

A. Characteristics of production cooperatives

In order to identify key issues affecting production cooperatives and develop recommended approaches and attitudes to them, it is first necessary to describe the significant characteristics of cooperatives, especially production cooperatives. Section B describes the cooperative movement with regard to each factor where a key issue has been identified. This section, in more general terms describes their general profile as a basis for identifying future trends.

1. Pluralism as the New Setting

The Soviet Union is going through a period where one of the key words in describing the Government's approach is "pluralism." Domestically and internationally, in the field of economics and in the field of politics, it is recognized that world problems have no simple or easy answers. Furthermore, the Soviet Union recognizes that there is no one answer to these problems and that rigidity of approach is the enemy of solution.

In common with most other countries, the Soviet Union has domestic economic problems: the intractable problems of inflation (the Soviet Union has an increasing problem of too many roubles chasing too few goods, especially consumer goods), and the need for increased productivity. Another aggravating factor present in the Soviet Union is the existence of a sizeable bureaucracy created in former times when progress was scheduled to be achieved through central state planning.

Bureaucracies are usually not well equipped to deal with times when economic flexibility and pluralism are called for. Therefore, not by plan, but in response to a need, the cooperative has emerged over the past two years.

2. Historical Background

A cooperative is by law an organization of three or more people, operated by its members in a permissible area of business activity under charter. If it conforms to its charter, and to government laws and regulations, if it pays its bills, taxes and other obligations, it is entitled to collect revenues and to keep and decide the disposition of any resulting profits.

There is a historical precedent for such organizations existing simultaneously and as an alternative to state-owned enterprises (SOEs). This was the period of the early 1920s of the New Economic Policy when it was Lenin's policy to foster pluralism in co-existence with the SOEs that were primarily engaged in heavy industry and the for-profit organizations allowed to continue to operate in other areas. As a result, today's cooperatives claim Lenin as their original creator and this gives the movement a certain respectability.

Over the years, the acceptability of this pluralistic approach has been varied. It was repressed under Stalin and was again abolished in favor of state planning exclusively, under Khrushchev. (It is noted from experience that the 1960s was a time when, on a worldwide scale, individual for-profit initiative was subordinated to central state planning). Most recently, under perestroika, this type of individual initiative has literally burst upon the scene. It has taken the cooperative form as decreed by the State in the first general law on the subject promulgated in 1987 and spelled out in more detail in May 1988.

3. High Rate of Growth

Perhaps the most notable feature of the cooperative movement is how fast cooperatives are being formed. There were, at least legally, none prior to 1987. The following shows the number of cooperatives and the number of persons employed by them as of certain dates:

	No. of Active Cooperatives	No. of Persons Employed
Jan. 1, 1988	13,900	155,800
Apr. 1, 1988	19,500	245,700
July 1, 1988	32,600	458,700
Jan. 1, 1989	77,500	1,396,500

Significantly, it should be noted that as of January 1, 1989, and estimated to still be true as of July, 1989, the rate of increase is still accelerating and there are currently estimated to be 100,000 cooperatives in active operation.

Annual revenues for cooperatives at the beginning of 1988 were at the annual rate of 350 million roubles. For calendar 1988, revenues were 6 billion roubles ^{2/}. In the first quarter of 1989, revenues were 4 billion roubles and it is estimated ^{3/} that the total for 1989 will be 17-20 billion roubles. Furthermore, for a variety of restrictive reasons, not all geographic areas are growing at the same rate, (a few areas actually declined) and it is estimated by the same source that lessening or removal of some of these barriers could raise annual revenues almost immediately to a 50 billion rouble annual rate.

The explosive rate of growth is shared, perhaps in even greater measure, by the production cooperatives. The subject of one of the case studies ^{4/} is only one year old and has revenues of over 40 million roubles and employment of 1700, being currently limited to this number by its charter. Another, Plastic Center, had revenues of 13 million roubles in its first year of operation during most of which period it had 300 employees. As of July 1, 1989, it has 2140 employees.

4. Service Cooperatives and Production Cooperatives

The cooperative movement began with individual entrepreneurs starting up a small service organization either to utilize their existent skills or in response to a perceived need. As of July 1, 1988, 72% of the active number of cooperatives and 63% of the revenues in the first half were from service activities, with restaurants the largest single identifiable category and garages and repair shops second. Even at that date, however, the balance of 28% of employees and 37% of revenues were from the production cooperatives, which also accounted for 31% of persons working in cooperatives.

As stated, it seems that this category is growing at a faster rate; it is also considered the most significant sector for the future. It is in this area that the experts' studies were concentrated.

5. Size of Cooperatives

The average cooperative has been, and remains, small in number of persons employed. The overall average as of July 1, 1989 was 15 persons and the average for production cooperatives was about the same. The service cooperatives, by their very nature, will remain small but the production cooperatives will continue to grow significantly in individual size to the point where the kind of cooperative on which attention of this report was focused, ones with employment into the thousands of people, will become increasingly common.

6. Fields of Activity

Being predominantly service activities in the beginning, the cooperatives exhibit great diversity. During the Cooperative Congress held at Moscow June 30 - July 1, 1989, the UNIDO experts met members of cooperatives engaged, for example, in film star representation, AIDS serum research, joint-venture negotiation, and a variety of consulting firms in such fields as design engineering, time study and methods, and economic forecasting.

As to production cooperatives, since most of them are also of opportunistic origin, many of them also have varied product lines. One of the case study companies ^{5/} switched from kindergarten playground equipment to sports club exercising machines and is looking into other fields as well.

Some others serve varied markets but with a common technology. Low Voltage, for example, in the electrical field, manufacturers and sells both industrial motor controls and consumer electric plugs and switches.

^{2/} One rouble equals approximately \$ US 1.54 at the official exchange rate.

^{3/} By M. Koropkin, Rector of Moscow Cooperative Institute.

^{4/} Moscow Low Level Voltage Equipment Plant, document ID/WG.498/2(SPEC.).

^{5/} "Start" Cooperative, document ID/WG.498/4 (SPEC.).

The flexibility of cooperatives guarantees them a certain rightful role in the economy. If a speedy or short-run or non-routine job is needed, the turn-around capabilities of a cooperative make it the natural recipient of such work. As one example, large buildings in the Soviet Union are usually built by state enterprises; sheds are often built by construction cooperatives.

7. Market and Consumer Orientation

Many of the cooperatives have a consumer orientation, most of them have a market orientation. Those whose origins evolved from an SOE were frequent in the Soviet Union (with a relative increase in the amount of roubles accumulating to the consumer arm of that enterprise). But the basic orientation of the cooperatives is that they are market driven. They are in fact the only market-driven business activity existent and with the extreme shortage of ability to satisfy the resulting increase in consumer demand, there is a bias toward consumer goods on the part of the new cooperatives because that is where the demand is and where the major new opportunities lie and opportunism is the direction in which entrepreneurs will naturally gravitate. Also, the greater demand in the consumer goods sector translates into greater possibilities for a higher return on investment.

8. Attitude Toward Government

The attitude of cooperative management is one of present dissatisfaction with Government, or, to be more precise about it, they are anti-bureaucracy. Their attitude toward bureaucracy borders on hatred and certainly contends that there is no possibility that the average bureaucrat will "see the light." One need only have attended the recent Cooperative Congress to identify this attitude unmistakably. Regrettably perhaps, there is no disposition to "work with" government functionaries and in response to their own difficulties, the mood of the cooperative is a mixture of defiance and fearful resignation.

Cooperative entrepreneurs pride themselves on their ability to cut through red tape. They consider it the weapon of an unthinking enemy. They admire a procedure only if it is simple, straightforward and direct and at the risk of oversimplification, they like proposals designed to solve their problems to have the same characteristics. As a result, at heart, many of these entrepreneurs are proving to be non-ideological. As the head of one major Republican cooperative ("Republics" are equivalent to a State) said, "We don't care whether this movement is socialist or capitalist. We are for it because it works."

9. Share of Gross National Product

Despite its phenomenal growth rate, cooperatives still have a long way to go before they are in fact a dominant or even a major player on the economic scene. It is estimated that they currently represent less than 1% of the gross national product and only a slightly higher percentage of total non-agricultural employment. This means there is a lot of room for growth before the movement slows down, but it also means that in terms of political power, they have potential as an economically significant alternative but do not yet wield major economic or political clout.

10. United States Cooperatives

A comparison of the Soviet cooperative movement with cooperatives in the United States shows that both operate on the "one-person one-vote" principle. However, they differ to the extent that the United States structure is not at this time a distinctly useful role model for the Soviet. For one thing, in the United States, the cooperative movement is but one of many variations in that country's basic economic pattern. In the Soviet Union, by contrast, the cooperative movement represents the only economic entity exposed to market forces and it is not really a full-fledged member of what is basically a state-controlled economic system. A description of the cooperative movement in the United States is included as annex I.

11. Trend for the Future

The cooperative movement is a peculiarly Soviet solution to the question of economically self-interested motivation. It is the only Soviet institution aimed toward a market-oriented and eventually perhaps a competitive-oriented economy. It is unique to the Soviet Union and does not directly resemble cooperatives in the West. The movement will grow significantly if unchecked and will grow even more if it is encouraged along the lines suggested further on in this report. For the Soviet Union at present, it is the only such approach now in existence available to be fostered and that any attempt at this early point in its life to shape it to match some foreign model more exactly would not be promising or advisable.

B. Key Issues

Within the world of Soviet cooperatives those issues have been identified that they are key to the future health and growth of the cooperative movement. The main characteristics of cooperatives have been described above and now in the balance of this Section the main problems are discussed that cooperatives face. Chapter III present recommendations on indicated ways to deal with those characteristics and problems. First, however, it seems wise to list what has been identified as the issues that contain the keys to success of the cooperative movement. Fifteen issues have been identified as "key"; these are listed below and are followed by detailed discussion of each.

1. Where does the greatest future prosperity and growth for cooperatives lie, with cooperatives that are sponsored by an SOE or with those that are fully independent of such a relationship? Often the distinction was brought about by origin. Was the cooperative spun off from an SOE or did it start up entirely newly created?
2. What is the best approach for providing smooth operation for cooperatives under conditions of material shortages?
3. Can credit be more efficiently supplied and utilized?
4. Should control over fixed assets evolve into ownership or lease, and what term of lease? Does ownership or lease of land and buildings and equipment need to be further assured?
5. What is a wise pricing program? What profit configuration seems advisable and likely?
6. How can the Soviet Union best capitalize on the labour productivity of cooperatives? Does this productivity justify the higher pay of the cooperatives compared to the SOE's?
7. What is the proper taxation program for cooperatives?
8. What restrictions, if any, should there be on membership vs. non-membership?
9. What restraints are needed on the present almost absolute operating authority of the Executive Director?
10. Is more public support of the cooperatives needed and how should such support be generated?
11. What are the longer-term merits of decentralizing government control over cooperatives to the local level?
12. What kind of legal framework is needed to further the welfare of cooperatives?
13. What are the prospects for cooperatives forming foreign joint ventures?
14. What is the mission of the Cooperative Association only now emerging and what should be its guiding principles for maximum effectiveness?

Key issue #1 -- Where does the greatest future prosperity and growth for cooperatives lie, with cooperatives that are sponsored by an SOE or with those that are fully independent of such a relationship?

Often the distinction was brought about by origin. Was the cooperative spun off from an SOE or did it start up entirely newly created?

The production cooperatives which are subject to this report arrived at their status by one of two basic routes. Some of them were departments or sections of SOEs where there was a willingness on the part of the SOE that the activity be converted to a cooperative. In some cases the activity was at or near bankruptcy, in other similar but more mild cases, there was an inability on the part of the SOE to finance the activity and hence a willingness that entrepreneurs (for a price) should take over. Often these activities were those of departments responsible to the parent SOE, charged to produce a given quota of consumer goods. With the SOE unwilling or unable to perform to this quota itself, it was willing that those who wanted to try be permitted to do so especially since the cooperative's performance would count against the SOE's consumer quota. Often these founders of the cooperative were the respected and competent department heads of the activity in question, eager to have a try at what they knew how to do, or felt capable of accomplishing.

The other route to becoming a cooperative represents pure entrepreneurship. A single individual or a small group (three being legally required) were determined to "start a business." In some cases, they did not have a predetermined idea what this business would be, or they changed their objective en route.

As will be seen, the first-mentioned kind of cooperatives benefitted from the fast start that the SOE could give them, usually in its own self-interest.

Of the larger producing cooperatives that are subject of this report, both types are represented. It has been estimated by the Government that about 80% of cooperatives are of SOE origin. There are no statistics on the point. All kinds of permutations and variations exist between the two types. It appears that the smaller production cooperatives are predominantly of the second type. The question is not which historic origin is preferable. The question is whether and for how long the faster start represented by the state-enterprise relationship is necessary and healthy. A related question is whether perpetuating the dependency of a cooperative on a state enterprise delays taking governmental measures that would "level the playing field" for all cooperatives and make them full members of the economic system rather than existing outside it as is somewhat the case now.

Key issue #2: What is the best approach for providing smooth operation for cooperatives under conditions of material shortages?

1. Shortages

Shortages of raw materials, components and intermediate components (and of finished product as well) is a major fact of industrial life in the Soviet Union today. This is true throughout the entire Soviet economy. Most probably, the causes are low productivity (which the cooperatives are in part assuming the role of correcting) and the misallocations of production, distribution and transport resulting from overcentralized state planning. One of the objectives of the new five-year plan is to correct this condition. Whether it can do so to a tolerable level remains to be seen. There is no possibility that it will do so quickly. In the meantime, the economy lives under chronic conditions of short supply and allocation.

As this is true for Soviet industry in general, it is even more true for consumer goods, the sector with the greatest growth and the greatest increased need for materials and supplies. In any case, cooperatives live under the country's more extreme conditions of raw material shortages. How have cooperatives reacted to this? In a typical way: by improvising, by searching constantly for available materials wherever they may turn up ^{6/} and by the following mechanisms described below.

^{6/} The UNIDO experts did not run across a single case of long-term supply contract for materials for production cooperatives.

2. Waste Material

Apparently waste material is not quota-controlled or if it is, quotas are not set forth realistically or as an important consideration. Waste material is heavily used by the cooperatives.

3. Barter

The prevalent use of barter applies to the securing of materials as well. In their ability to barter their own finished products for raw material, cooperatives have two advantages:

- a. By state SOE norms, they "overproduce" and are free to do so. Some of their excess production is used for barter.
- b. While the predominant customers for production cooperatives are the state distribution agencies sold to at controlled prices, the cooperatives are free to sell to retail customers with latitude as to prices, terms and conditions. This presents another opportunity for barter.

4. Help from the SOEs

For those cooperatives that were spun off from SOEs, the help they get from their former parent extends to procuring raw material as well. The SOE is able to add its economic bargaining power and purchasing know-how to that of the cooperative.

5. The Material Cost Mark-up System

State ownership of industrial production is by definition not a profit-oriented activity. SOEs secure their materials "at cost." These costs are planned costs, allegedly fixed to unchanged forecast conditions over the period of a five-year plan. They are bound in many cases to be highly inaccurate, but in theory, at least, they represent cost, and not a mark-up on cost. By contrast, many cooperatives operate under a cost mark-up system. The price paid is not "cost" but a predetermined multiple of that same cost. It is not completely clear yet, by what governmental organ cost multiples are set, but the marked up costs have two characteristics:

1. They vary from one cooperative to another and from one community to another.
2. They are high and in total represent an important component of total cost.

a. Variation

There appears to be some flexibility to cost multiples but at least in any one region there are typical mark-ups depending on the kind of material involved. Mark-ups ranging from two times to six times appear to be most common.

b. Material cost as a major component

Table 1 in annex II to this report illustrates the economic importance of this cost mark-up system. It shows an illustrative product cost profile for goods produced by a cooperative and an SOE. These profiles are not specific but representative. Note that for a cooperative with a typical profile in which material represents 40% of total cost ^{7/} the amount of material cost is a typical 4 times multiple and total cost is raised approximately 40% over what it would have been if prices available to the SOE had applied. Put another way, pre-tax profits would have been increased 125% if the SOE material price had applied.

^{7/} It should be kept in mind that "material" does not have the same meaning as in Western accounting but includes everything other than payroll costs. The differences in cost and profit ascribed to the "material" cost mark-up in this paragraph have been allowed for but the numbers in table 1 may be somewhat overstated.

This illustrates graphically the lack of "level playing field" with the SOEs of which the cooperatives complain. ^{8/}

The cost mark-up system in fact represents and is intended to be a compensatory tax. For the SOE, the mark-up to wholesale price and subsequently to retail is a sales tax that is passed along to the consumer. The cooperative's cost mark-up is intended as a compensatory tax paid by the cooperative directly to the State. As the typical example in table 1 shows, it is usually more than an equalization of the tax paid by SOEs.

6. Import Restrictions

In some instances, the finished goods supplied now offered by the cooperatives were, if available at all, formerly imported. While producers have sometimes, once producing, been protected against competitive imports by quotas and duties, heavy duties have been imposed on imported components. In one case a 2000% tax on certain imported components was newly imposed. In fact, most of these duties are totally prohibitive economically. As a result, producers have had to rely on exclusively domestic materials. In many cases, quality has suffered and domestic producers have been effectively shut out of competing internationally from domestic production, especially in goods at the high technology end of the

7. Central Planning

It can be seen from the above instances that central planning is one of the underlying "enemies" of the cooperative system. Central planning, especially over a lengthy period of time, such as five years, assumes a relatively rigid economy that does not forecast or allow for dynamic changes or unexpected growth. In any such plan, especially in a shortage condition requiring allocations, the fast-growing cooperatives will get the short end of things.

Furthermore, while it is beyond the scope of this report, it is assumed that the physically centralized structure of the Soviet economy works against the cooperatives. Central planning fits more naturally with an enterprise that is single-source monopolistic with few sources of supply and a regulated distribution system with physically centralized distribution and transport systems. Cooperatives, at least at their present stage of development, are decentralized and therefore less compatible with such a system. It is one of the objects of the Soviet Government to decentralize its economy but there is a long way to go before this is the dominant mode and before it is overhauled to a major extent where cooperatives can feel comfortable. In summary, the fact is that in terms of obtaining materials (and equipment as well), cooperatives are totally left out of provisions under the current system.

Key issue #3: Can credit be more efficiently supplied and utilized?

1. Credit Problems

a. Growth requires cash.

One of the major characteristics of cooperatives has already been discussed: that they are experiencing a growth rate that is still accelerating. At least under conditions in early 1989 the cooperatives' problem may well be not profit difficulties, but cash difficulties--the resources to finance requirements for growth in facilities requirements and requirements for working capital.

^{8/} Both cooperatives and at least some representatives of state-owned enterprises contend that the "playing field" is tilted against them and in favor of the other. It seems the cooperatives' contention that the economic system is slanted to their disadvantage is the correct one.

In the Western industrial economies this problem is very common to start-up operations that experience rapid initial growth. It is, despite profits, a frequent cause of early failures and bankruptcies. That such a result does not occur more often in the West is because of the general availability of credit. This is available broadly because of the existence of an equity market and through short-term and long-term debt, both supplied in part by the banking system. The first source, equity investment, is not available in the Soviet Union, except as there has been capital accumulation by individuals already closely associated with forming the cooperative. The effectiveness of the banking system and its willingness and ability to finance growth have been mixed but are improving. There was one case where bank credit was not promptly available to a new cooperative which fortunately could turn instead to its parent SOE for loan funds. On the other hand, in another instance a cooperative financed out its equipment purchase with a bank rate at the favorable rate of 4% per year. The effect of growth on cash flow is illustrated in annex II, table 2. This is the same typical cooperative example already referred to in table 1. In table 2, the cooperative is shown as experiencing a revenue growth rate of 50% year to year, a fast growth rate but slower than that currently applying for most production cooperatives. From 1988 to 1989, for example, cooperatives in total are experiencing a revenue growth rate of around 200%. Production cooperatives in the second quarter of 1988 experienced an annualized revenue growth of 280% over the first quarter.

Table 2 shows that at an increased tax rate the cooperative must borrow if it grows by even 50%. The breakeven point where continued borrowing is required is at around a 13% tax rate. That the numbers are not even more severe is due to the assumption of the continued high profit rate recently experienced by most cooperatives. On the other hand, continuation of such growth rates might well require more than normal facilities expansion. (This table was prepared primarily for a discussion of taxation, which follows later).

The role of the banks, present and future, in financing cooperatives is discussed below.

b. Payment Terms

The government distribution system, which represents by far the principal customer for most cooperatives, apparently pays its bills in a matter of days. This has a dramatically favorable effect on cash flow. The experience shows that it is very common all over the world for government-owned industry to be slow-paying. Moreover, the reasons why the UNIDO experts are skeptical about the continuation of rapid schedules of payment is because, based on the information available, there does not exist a system of discount for early payment. This is the principal mechanism used in Western economies to stimulate prompt payment. If this favorable liquidation of accounts, receivable were to slow down, it would have serious consequences for cooperatives growth (and of course for the entire economy.)

c. Inventory Accumulation

It was not possible to obtain any comprehensive figures on inventory accumulation either of cooperatives or, for that matter, of SOEs. But it seems that everything in the system works in the direction of heavy inventory accumulation. There is the lack of assured and regular supply of materials, the fact that cooperatives are frequently asked to hold merchandise pending shipment, and the relatively less extensive use of computerized inventory control, the principal means by which industry in Western countries has been kept under control in the last 10 - 15 years.

Furthermore, the UNIDO experts encountered frequent reference by cooperatives to periods of heavy inventory accumulation and liquidation.

inventory accumulation and stockpiling could therefore represent a continued important credit requirement. It is bank credit that customarily supplies this means of financing working capital.

d. Debt Transfer

Most operations, whether they are SOEs (or cooperatives that are able to survive) accumulate mounting debts over a period of time if they experience losses or inadequate profits. In the case of SOEs, these are of course government-supplied funds and government debts. Such support is not and should not be available to a cooperative.

The UNIDO experts were informed of one instance where a cooperative spinning off from an SOE was required to carry with it some portion of the SOE's debt. Since circumstances differ, there is no one rule that represents the right treatment for accumulated debts. But where debt is a result of chronic losses rather than momentary start-up expense, realism suggests that much or all of the investment put into the SOE has already been lost. Given any choice, a potential cooperative will rightfully oppose being responsible for such past losses. If this practice of debt transfer is, or becomes widespread, it is bound to create a drag on formation of new cooperatives. The experience shows that Governments with such debts are reluctant to accept the financial and political consequences of writing them off but in the end wisely have to do so.

e. Bank Response

In numerous instances the response of the State Bank to providing needed credit to cooperatives was somewhat slow in being authorized or state-owned enterprise customers took precedence. In general, however, this was not a problem. Further banking competition, now developing, will further lessen the problem. A vitalized, responsive banking system is essential to the continued growth of the cooperative movement.

2. Role of Banks

The Soviet Union had a viable cooperative bank serving a strong cooperative enterprise system in the 1920s. This bank was eliminated about 1926 along with the elimination of the cooperatives as part of the restructuring of the economy at that time.

Six decades later, cooperative banks have reappeared following the enactment of the Law on Cooperatives in May 1988. Cooperative banks are registered with and regulated by the State Bank in Moscow in accordance with regulations pertaining to cooperative, joint stock and commercial banks (together called "commercial banks").

As of June 30, 1989, there were 43 cooperative banks registered and another 16 applications pending. At the same time, there were 76 other commercial banks with 32 applications pending. Since by the State Bank's own regulations applications are processed within one month, the rapid growth of these banks is apparent. Review of a list of the registered banks indicates they are widely spread among the republics.

A key distinction between cooperative and commercial banks is that the former are primarily intended to serve cooperatives while the latter are primarily intended to serve state enterprises. In actual practice, it tends to be working out this way, but there is substantial overlap in types of shareholders since the regulations do not differentiate who the owners can be.

The banks themselves have chosen to continue this overlap, at least for the time being, through their All Union Association of Commercial and Cooperative Banks, which presently has 58 members.

In actual practice, state banks give first preference to state enterprises and cooperative banks are still too few in number to service all the cooperatives adequately. Therefore, in the end, the credit needs of cooperatives currently still have second priority and the cooperatives sometimes suffer for this. The Law on Cooperatives seems to intend that cooperative banks be established primarily by cooperative associations. The State Bank regulations broaden eligible ownership substantially to include as founders-shareholders of commercial banks (including cooperatives) ministries, administrations, other state agencies, banks, associations, enterprises, organizations, offices, cooperative associations, cooperatives and public organization; thus, only individuals apparently are excluded.

Organizations purchase shares in a bank voluntarily. Shareholders elect members to the bank Council at a general meeting. The Council determines bank policy and appoints a professionally qualified chief executive officer (with the title of either Chairman or President). Bank councils meet semi-annually or at least annually. Thus, bank control is by democratic processes within the context of the Law on Cooperatives and State Bank regulations.

Bank management guidelines are provided to some extent in State Bank "letters," especially regarding financial procedures and practices. Given the rapid growth of these banks and the non-existence of a private banking system until 1988, there is a lack of experienced bank managers. Apparently most cooperative banks have been recruiting managers from the State Bank and its related special banks as well as financial specialists in ministries and state enterprises. Clearly there is an important need for training programs for bank managers.

Cooperative banks are required to have at least one-half million roubles in paid-in shareholders equity. They mobilize capital through savings demand and time deposits and loans from member cooperatives, state banks and state-owned enterprises. At least one cooperative bank is considering a bond issue to raise longterm capital.

Bank loans are made to cooperatives as well as to individuals and even to state enterprises. Annual interest rates range from 10-18% with repayment periods up to 18 months (few longer). Since the average cost of capital is less than 4%, profit margins can be substantial.

To date the more active cooperative banks have been able to attract adequate capital to meet growing loan demand. With projected high rates of growth in cooperatives and their capital needs, future capital adequacy is uncertain. As the number of banks increases, competition may begin. Excessive regulation and high taxation are the prevalent concerns of bank managers.

Within the past year, the growing number of cooperative banks throughout the Soviet Union has begun to meet the rapidly growing demand for capital by cooperatives. As of June 30, 1989, there were 43 cooperative banks registered but not all were active. In this limited time, the more aggressive banks have been able to mobilize adequate capital to meet the effective loan demand of cooperatives in these local market areas. As loan demand increases and more banks become active, capital resources may not be as readily available at present low interest rates in any event. Higher interest rates may become necessary to both the banks and their cooperative borrowers. Such adjustments probably could be made in a context of growing economic opportunity and reasonable government taxation and control. Bank managers are confident that they can adjust to increasing competition for resources and clients.

Key issue #4: Should control over fixed assets evolve into ownership or lease, and what term of lease? Does ownership or use of land, buildings and equipment need to be further assured?

1. Private Ownership?

Private ownership of land does not occur and is not legal in the Soviet Union. Private ownership of buildings is permissible but not common. The question of private ownership of buildings becomes critical when the need for expansion is considered. In the case of Low Voltage Equipment, for example, it is operationally desirable and may well become essential that further manufacturing space be obtained. The present facilities are old and cut up to the point where work flow represents a major inefficiency. The optimum solution would be a single new facility, owned by the cooperative on leased land. One obstacle to this solution is the absence of sufficient capital to accomplish it. This obstacle may be overcome by locating a joint venture partner whose contribution would be the capital for such a building. Beyond this, the probable solution that will have to be adopted is retention of the old facility which is owned and the addition of a new facility either owned or on lease. This presents numerous less-than-ideal legal and operational complications but is not unmanageable.

Many of the cooperatives that were spun off from a parent State enterprise continue to occupy common premises under lease. In these circumstances, the cooperative is dependent on the SOE for heat, light and power, which is part of the lease.

2. Lease Periods

The problem with leases is not so much their unavailability or other conditions of tenancy but their length of term. There is no set term of lease; leases as long as ten years but also many with no term at all were encountered. Some cooperative officials take this matter somewhat lightly. Indeed relationships between lessor, (the SOE or some branch, usually local, of the Government) and lessee (the cooperative) have been satisfactory on the subject of lease continuation. Future problems will arise under two conditions: those under which the cooperative is either doing very well, or not well enough. As the need for expansion of facilities becomes more pressing, the need for permanent investment on leased land and in most cases in leased buildings will become a subject of major concern for the cooperative. In order to earn an adequate return on its investment, the cooperatives will seek assurance that they can continue operations on some basis more solid than the mere goodwill of the lessor.

The other circumstance in which lease term will become a major concern is if a cooperative gets into financial difficulty. Under such circumstances it needs assurance that it has a reasonable opportunity to work through its difficulties without the added threat of eviction. While no case of this severity has been brought to the experts' attention, there is one case where a major production cooperative with volume still expanding rapidly, nevertheless expects 1989 income to be less than in 1988 because of increased labour costs.

3. Equipment

Ownership of equipment, and more rarely of buildings, has come about where it occurs, principally through the sufferance of a SOE divesting itself of an operation to a newly formed cooperative. The SOE appears to have made such arrangements for a variety of motives, anywhere from wanting its newly separated operation to succeed, to being unable to finance expanded operations itself, to securing a more favorable price from the cooperative than might be obtained elsewhere.

Leases covering such arrangements are far more common, not only for buildings but for equipment, even when it is second-hand.

a. Source of Equipment

No area of operations illustrates the improvisational nature of cooperative operations more clearly than the history most cooperatives have undergone in securing first equipment and subsequently a continuing supply of raw materials.

In most cases reviewed, equipment secured was used equipment. Where this was equipment already in place being used by an SOE prior to converting to a cooperative, this presents no problem except for the aging condition of the equipment. But in other cases, especially those where a cooperative is starting up new or is starting up a new product line, the problem has been severe. Only ingenuity and determination have enabled the cooperatives to do as well in securing equipment as they have. First the equipment, almost always second-hand, often having been idle, and in poor condition, has to be located. It then has to be purchased, put in shape or adapted, and installed. Those cooperatives that evolved from an SOE have used the help of their friendly former parent liberally. Most SOEs have equipment allocations. While they need them themselves, they have in some cases been willing to give up part of this allocation to the cooperative. Perhaps just as important is the use of the former SOE parent's bartering power. Most SOE parents make industrial goods. Most operating equipment is in the hands of industrial SOE producers. The opportunities for barter therefore exist. This was especially noted in the machine tools sector. In one case, a cooperative intending to make consumer wire goods ^{9/} was able to secure equipment by trading its former parent's finished milling machine product. Barter, in any case, is an important component of equipment procurement.

b. Paying for Equipment

There is a set "standard" practice, at least in the Moscow area, as to the purchase price for equipment. SOEs purchasing equipment do so, as far as new equipment is concerned, at "cost," i.e., the state-determined purchase or transfer price. In the case of used equipment, they pay depreciated book value. For cooperatives, however, in at least some cases, the purchase price is depreciated book value marked up two times, that is, double.

This is an illustration of one of the cooperatives' major complaints, the absence of a "level playing field" between themselves and the SOEs. As will be illustrated in examples later on, cooperatives pay substantially more taxes proportionately than SOEs do, and feel they should be accorded at least equal pricing treatment. The fact is that leasing of equipment is far more prevalent than ownership for all these reasons.

Low Voltage Equipment's ownership of its equipment is interesting. When it was spun off from its parent SOE (State Electro Technical Industries), the negotiated terms were that it would pay 6 million roubles for building and equipment, having until 1995 to pay, with 6% annual interest. On its own initiative, Low Voltage Equipment secured a bank loan at a State Bank for the entire amount at a 4% rate of interest. Hence, it was able to pay off its indebtedness to its former parent in full and own its own equipment sooner, at a lower cost.

^{9/} Maiak Cooperative, document ID/WG.498/5(SPEC.).

4. Spin-off

We noted a number of times when cooperatives, whether spun-off from a parent SOE or newly created, have in turn spun off some of their own operations capable of being disassociated. Examples are maintenance shops, transport operations, and a variety of design and process engineering activities. Part of this occurs because forming cooperatives is very much "in fashion" with large numbers of senior participants seeing at first hand the attractiveness of being one's own entrepreneurial "boss." Another motivation is that legally, if not operationally and financially, it has been relatively easy to do. Comparatively, it holds reasonable promise of high profits and seems a good, if uncertain, place to put one's money. Once one's provision of service and the market for it is assured under the sponsorship of a parent cooperative, the principal hurdle to formation seems overcome.

5. Hybrids

One interesting "hybrid" variety of cooperative is given here; it is assumed that there are others of equal interest. This is a "cooperative" of sorts called "Mosintek." It is in effect a holding company of fair size including under its umbrella 50 cooperatives and 80 SOEs, most of them small and in general with a heavy scientific orientation. It has established relations with the Harvard Russian Center and has concluded some joint ventures. It has secured as its Executive Director a man with considerable Western experience and contacts. It is considered by the Government to be an experiment and on the face of it seems an interesting way to weave together more closely the advantages of both the established (SOE) and the more newly created (cooperative) forms of organization, hopefully drawing on the strengths of each.

There are also other interesting and promising hybrid forms that are deviations from the norm and it is assumed that there are others as well.

Key issue #5: What is a wise pricing program? What profit configuration seems advisable and likely?

1. Distribution transfer prices

The principal customer of most of the cooperatives reviewed was the State-owned wholesale distribution agency. While cooperatives are free, in theory at least, to sell retail direct at whatever price they choose, in most cases the majority of sales, often at least 80%, is made to the State wholesale distribution agency.

In all cases encountered, these sales were at prices no higher than those at which the SOEs transferred their product and in some cases were willingly negotiated lower. ^{10/}

Table 1 shows reasonably representative cost profiles comparative between cooperatives and SOEs. In addition the following specific example of ladies' hosiery is also illustrative:

	<u>Roubles</u>	
	<u>COOP</u>	<u>SOE</u>
Retail price	3.65	3.65
Retail cost	3.30	3.30
Wholesale cost	over 0.7955	0.30
Material cost	0.75	0.15
Mfrs. value added	0.0255	0.15

^{10/} In one case, by using substitutable materials of lighter weight, the production cooperative was able to offer an at least equal quality product to that provided by its SOE competitor at a lower price, presumably overcoming the extreme penalty from the cost mark-up system. Its competitor SOE used undesirable heavier material because it was "traditional" to do so.

In this one instance, the only specific one encountered by the experts, the cooperative was forced to sell to the wholesaler at a higher price because of the cost mark-up tax applied, which made comparable wholesale pricing not possible.

Note, however, the large mark-up taken by the state distribution agency. It is passed along to the consumer in what in effect is a sales tax. The state wholesale margin is sufficiently sizeable to practically invite the cooperative to enter the retail field, which is all to the good. Note further that a concerted effort by the cooperative to enter the retail field would provide the possibility eventually of a lower consumer price, given the producing cooperative's potential 77% value added margin.

It is interesting to note that the UNIDO experts learned of no reference to any wholesale distribution cooperative. The elimination of this monopoly mark-up and the introduction of competition at the wholesale, and ultimately the retail level seems an excellent way to lower prices to consumers - except as shortages and price controls would currently interfere with such a programme.

2. High Profit Margins

For reasons such as the above and of which table 1 is typical, production cooperative margins appear to be high. There were several cases where after tax (so far relatively nominal in amount) profit margins were 50%, 40%, and 27%, respectively. This despite the penalty mark-up paid on material.

This high mark-up, as has been seen, is the saving grace for the cooperative from a cash flow point of view and is what makes it possible, under present conditions, for cooperatives to shoulder a certain amount of additional tax. Table 1 shows that even the SOEs achieve what would, if they were independent entities, be a good profit margin. This appears to be a reflection of what is probably a costly, inefficient, monopolistic distribution system.

3. Subsidies

Cooperatives should be as private and as independent of Government and SOEs as possible. Thus subsidies of any kind are not desirable. On the other hand, cooperatives should pay fair and equal prices for materials, equipment and buildings and be taxed at reasonable rates. Cooperatives are presently able and need to be able to borrow from both cooperative and commercial banks at low interest rates similar to SOEs.

4. Price Control

All SOEs operate under a State system of price control that is complete. Cooperatives are tied to this system, but because they are able to by-pass the substantial consumer taxes levelled at the wholesale and retail levels, they benefit from it in profit margins, given reasonable operating efficiency. One is tempted to argue that a planned reduction of price levels by forced reductions in price controls, even their removal altogether, is the best way to achieve the ultimate objective: lower consumer prices. There are three problems with this approach:

1. In general, the experience in price controlled economies suggests that precipitate removal or even relaxation of price controls under conditions of chronic shortage are an invitation to skyrocketing inflation. Recent inflation in the Soviet Union has been bad enough to be already politically unacceptable.
2. A comprehensive price control system is so interwoven with the economy that it is difficult to know where to begin. Any change in any one part of the mechanism generates a great many ripple effects, a lot of them unforeseen and unintended.

3. More basically, the free market economies have proven time and again that price controls just don't work over any extended period of time. They are, therefore, not an effective weapon and not to be relied upon. Furthering the cooperative movement is a better angle from which to attack the Soviet Union's market problems than experimentation with price control programs.

5. The social fund

In the United States after all costs and expenses are paid, the amounts remaining are disposed of either by (1) spending them for various corporate purposes now, or earmarking them for certain specific purposes in the future (called "reserves") or by (2) keeping them for future general use (called "retained earning"). Most reserves, charitable deductions and bonuses are tax-deductible; dividends and retained earnings are not.

In the Soviet Union, none of these present or intended expenses except regular bonus programs as part of the wage program are tax deductible. The concept of reserves and charitable donations does not therefore have meaning in the Western sense. Moreover, the philosophy surrounding these intentions and the very word terms used are different. Money intended as supplemental bonus distributions to members is declared and spent. Money possibly intended for them or for other general social purposes is designated as being part of either the "payroll fund" or the "social fund." Money retained for future use in the business, usually being saved for future reinvestment is designed as being a retained fund. None of these intended future distributions has legal force although since commitment of intention is made to and passed on by the members, any change in eventual disposition would have to have logical explanation and be cleared by the membership. These declarations of intention can affect the tax rate levied. Intended distribution does not have accounting or legal force.

6. Reinvestment

In summary of the above, when all mandatory payments have been made by a cooperative, there are only three alternative uses to which residual after-tax profits can be put.

1. Make voluntary payments to the social fund, spend money for other social purposes or raise expenditures voluntarily for increased wages, for example.
2. Distribute proceeds not useful in the business to workers, members, etc. outside of and in addition to regular bonus plans.
3. Retain earnings for future use.

One can find cooperative managers using profits for purposes 1 and 3, but not for 2. Many of the more responsible producing cooperatives are making excess social fund payments as part of a public relations program. One has decided that its after-tax social fund expenditures and retained profits split will be 70/30. (Note again that none of these contributions or reserves are deductible). In the end, one of the main procedural differences between a cooperative and an SOE is the freedom and willingness of the cooperative to raise wages substantially above the SOE level where management thinks operations will benefit.

7. Working bonuses: profit distributions

The concept of individually earned bonuses for workers is almost universal in the cooperatives. The concept of dividends paid to a person because he is an owner, as opposed to being a worker, is virtually unknown.

8. Intended Future Use of Funds

But the basic objective of every Director the experts talked to, is to use profits generated to build and expand the business. Given the growth profile of cooperatives as previously described, this is not surprising.

9. Summary: profit profile

It is felt that the present profit profile of the producing cooperative, its market and consumer orientation, its rapid growth, its high profits and its reinvestment policies fit together logically and exhibit a consistent profile. Only competition in the marketplace is missing, but that can only materialize when cooperatives represent a higher proportion of the gross national product.

Key issue #6: How can the Soviet Union best capitalize on the labor productivity of cooperatives? Does this productivity justify the higher pay of the cooperatives compared to SOEs?

1. Higher Productivity

Opinions differ as to whether producer cooperatives are now more efficient than SOEs. Cooperative management claims with great force that they are, and several times so. The fact that cooperatives can pay a wage and bonus that in total, at least for the larger cooperatives, may be double that of SOEs, and still make a high profit margin tends to support this claim. (It is doubtful that the high profits can be laid entirely at the door of an inefficient distribution system). The several points that follow in discussion tend to support this further. On the other hand, some government officials and academicians claim that this is not the case. They claim the lack of sufficient volume to have yet justified mechanization to the same degree as in the SOEs results in lower productivity. We challenge this from a number of points of view.

On balance, while there has been no way to check it, logic and such evidence as there is suggest that the producing cooperatives are right and they are more efficient. At the least, this seems to be the case with the larger, better ones. Most probably, both produce greater quantities of goods in a given time period and do so more efficiently.

There is not real question that cooperative workers work longer hours at staff, supervisory and worker levels. They also appear to work harder.

2. Piece Rate

Piece rate is the predominant system of pay in producer cooperatives. We ran across cases of tightening of piece rates, so in these instances at least, conscientious attempt to link piece rates to efficiency and keep them up to date is made.

Experience of Western economies with piece rates suggests that they are troublesome to administer but almost always worth it in efficiency. This is especially true with individual piece rates as compared with group piece rates.

3. Incentive Compensation

Individual bonus payments are woven into the compensation patterns of many producing cooperatives. Moreover, bonus payments can be and are substantial. To begin with, base salaries are at least 50% and often 100% of what is mandated for SOEs. Thereafter, at least in two instances, bonus payments run up to equal or slightly less than base pay. In one case, they are tied to objective factors such as quantity and quality of production, with management bonuses also dependent on worker performance. In the second case, they may not be as objectively determined. Bonuses are, however, recommended by each individual's supervisor and approved in turn by his supervisor. This is a practice basically the same as that in the Western economies.

4. Market Orientation

One of the key elements of cooperative productivity has to do with the ingenuity with which it approaches its tasks. If a market need exists, cooperative management assigns the task, a team and a pay schedule and this combination rises to the challenge set for it. For example, in the industrial goods field, Micron Cooperative, a complex and technically very sophisticated tool and die cooperative, quotes on a die set, assigns a team and a team leader and based on its quote, tells the team leader how much in total it will pay, leaving it to him, even without management knowledge, to "divide up the pot." It claims it has never been caught with a bad estimate and it has a 40% profit margin.

The rationale for branching out into new products is most often due to a perceived, almost randomly encountered, market opportunity. Maiak Cooperative, for example, branched out into TV antennae, a field previously foreign to it, because it responded to the need for correction of poor reception in Moscow of a popular channel in Leningrad.

5. Managerial Skills and Systems

There is a severe shortage of managerial and technical skills in the Soviet Union that continues to limit expansion capabilities of cooperatives. In the United States, marketing and financial skills, in that order, are the two most common sources of top management talent although this priority is somewhat unique in the world. In every one of the production cooperatives reviewed, an individual with engineering training was the Executive Director. In Ftorpolymermach, a technically oriented cooperative in Kiev, engineering training is so important that they train 300 established engineers of other associated cooperatives a year. This is not only done free of charge, the cooperative pays subsistence during the training period. It does, however, establish that engineering work subsequently be supplied to it at normal price rates.

Special note is also taken of the need for management information systems (and the data processing equipment to back it up) that exists throughout the Soviet Union. Accounting is another specialized talent that is in short supply.

6. Employment Shifts

Evidence is not available, but there has apparently been a shift of employment into production cooperatives that can only have come out of SOEs. The expert's estimate is that almost 30,000 people will have transferred by the end of 1989. In any case, it is a significant enough number for the new Deputy Prime Minister to have publicly complained about it.

7. The Experience Curve

In the Western economies a phenomenon known as "the experience curve" has been identified and measured. The experience curve states that every time production of an identical item is doubled, total cost is cut by anywhere from 10% to 30% with about 20% most common. With cooperative growth rates still growing at a rate still more than doubling in 1989, the effect of the experience curve is still being applied to a significant degree.

All the above points argue in favor of greater labour productivity coming out of the production cooperatives than out of comparable SOEs. About the only important factor arguing in the other direction in favor of greater productivity from the SOEs is the fact that SOEs still have more capital behind each worker. Moreover, much of it is of the sort that leads directly to greater productivity: more mechanization, more automation, and perhaps more application of work methods. This of course will change, and change fairly rapidly as cooperatives grow, accumulate cash, and reinvest it.

On balance, at the very least, today a cooperative hypothetically identical with an SOE would produce at least 30% more goods at 35% less labour cost per unit, and this may be a conservative estimate.

It is this conservative estimate that has been incorporated into table 1. Since the larger production cooperatives at least are paying almost double what SOEs pay and are profitable in doing so, this represents their floor in superior productivity achievement.

Key issue #7: What is the proper taxation programme for cooperatives?

1. Key Impediment

At this point in time, July 1989, the most important issue immediately before cooperatives is a pending change in the tax rate applying to them effective this month. Description of present tax rates and what is known about future tax rates is discussed below. While the proposed tax rate range is scaled down from what was originally proposed, at the current upper end of the new range, 5% to 60%, the tax rate would clearly be confiscatory to many cooperatives. Such a rate, if applied widely, would have a major dampening effect on the growth of existing cooperatives and an at least equally adverse effect on cooperative formation.

Of equal importance to the above facts, is the question of perceptions. It is important that without exception, every person associated with the cooperative movement who was asked the question, "What is the most important issue currently facing cooperatives?" replied, "Taxation." The fact that they think it so important is in itself of importance. "Taxation" has become a rallying cry, a symbol of faith in the movement. It represents a no-compromise, anti-government position for the cooperative movement. Sentiments are so strong that the opinion, the Government should take serious account of them, should be paid attention to.

There is real apprehension on this subject of increased taxation because proponents of cooperatives interpret history as backing them up in the contention that taxation policy could crush the movement. Twice before, as they would have it, a budding cooperative movement was crushed, in the late 1920s and again in 1960, and taxation was the means employed to do so.

2. Uncertainty

Almost as serious as the anticipated increase in tax rates is the uncertainty that it creates. The one thing concrete business planning cannot abide is uncertainty. There is no question but that the Government is perceived as sending mixed signals on its support for cooperatives. All in the space of two years it has passed a law encouraging cooperatives and has passed regulations limiting their scope and provoking a negative feeling. It has given relatively lenient tax treatment to cooperatives but is now in the process of tightening this severely. It has endorsed cooperatives but warned of their excesses. (Perhaps this is natural).

The UNIDO experts are not competent to judge the issue, but there is much contention in cooperative circles that the new tax law is unconstitutional on the grounds that it supersedes present tax schedules after too short an interval. Whatever the merits of this position, it underlines the feeling once again that uncertainty is one of the worst aspects of the current taxation situation. This uncertainty about the future may itself be one of the reasons for the high prices from the service cooperatives of which the public complains.

The remedy suggested is that the tax decree from the Supreme Soviet either be suspended or cancelled. ^{11/}

Which route is chosen is less important than taking some action to settle the issue on adequate terms.

^{11/} In a rare gesture of accommodation, the recent Cooperatives Congress membership present voted about 2 to 1 in favor of suspension.

3. Tax structure - cooperatives

Under the law prevailing at least up to July 1, 1989, cooperatives pay three taxes (not including any sales tax paid by the purchaser):

1. A tax in the form of mark-up on materials. As discussed, this differs by type of time and perhaps by region. It is not present in all cases. It is paid to the Government as compensatory for the tax passed on to consumers on State enterprise-produced goods.
2. An "income-tax". This is paid on "value added," i.e., revenues less material cost. The pre-July schedule was moderately graduated, being 2% in the first year of operation, 3 to 5% in the second year of operation and 10% in the third year of operation.
3. In addition, members pay an income tax on their earnings. This is basically not graduated, being 8.2% on the first 100 roubles per month and 13% above that. Since wages in production cooperatives are almost always more than for workers in SOEs, this represents an additional amount of tax paid by members of cooperatives.

The new income tax after July 1, 1989, was originally announced as being 30% to 90% but is now announced as reduced to 5% to 60%, (at least in the Russian Republic) with the lower rates applicable to medical cooperatives and other activities judged socially worthwhile. From this range, however, the specific tax rate selected is decided by the republic based on guidelines provided at the national level. From this base, exemptions that could be substantial are decided on a case by case basis at the local council level. Payment will be made to the local level which will keep all or most of the remittance.

It is understood that for production cooperatives, the base rate will, in general, but with significant variations, be around 30% of value added. The tax rates proposed is 60%, which would be the equivalent for a typical production cooperative, such as is shown in table 1, of 20% VAT.

4. Tax structure - State-owned enterprises

State-owned enterprises also pay a tax on value added. It is stated to be 17% to 25% of value added. SOEs are not subject to the material cost mark-up tax. Since the SOE belongs to the State, all profits "left over" as a result of their operations can be looked on as a tax since the residual funds belong to the Government. It is further understood that the State-owned enterprises only rarely keep a small portion of retained profits. (Permitting this retention, or some portion of it, might be a first step in introducing the profit motive to SOEs).

5. Equalization

Even looked at in the most extreme way, taxes for an otherwise equal State-owned enterprise and a cooperative are weighted against the cooperative. This is illustrated in the example in table 1. In that example, even with a 10% value added tax, the cooperative pays 70% more tax even when all of the State enterprise "profit" is considered as tax. Of course, if the tax on cooperatives is raised to 25% of value added, the tax discrepancy is further increased and it happens that at that level of taxation profit after tax in this particular example is eliminated.

This example illustrates clearly the two positions that cooperative members take on the pending tax schedule and which are shared by the experts:

1. It clearly makes even more unequal tax discrimination against cooperatives compared to State enterprises.
2. The new tax schedule is confiscatory (at 60%, it is clearly so and even 30% is a severe depressant on profits but even more so on cash flow.)

6. Restraint

Let us take a somewhat broader look at the new tax legislation. Let us start by allowing that all tax decrees represent governmental policy in action and have an effect in one direction or another. There is no such thing as a "policy neutral" tax.

The cooperative movement is young and fast growing. The Government, despite some actions giving appearance to the contrary, has stated that the growth of cooperatives is a good thing, in line with Government policy.

Under these circumstances, the new tax decree represents too sharp a blow to the cooperative movement delivered too early in its history. While there are some public complaints against cooperatives, discussed below, we do not see that any major unfavorable effect on the whole economy has yet developed from the growth of the cooperative movement. In fact, it is not possible to really define any permanent trends yet. It would seem that tax restraint by the Government is in order: a less severe impact applied more slowly and perhaps even delayed pending a period of study.

Cooperatives are an "infant" industry. Most Governments use taxation to encourage those infant industries they favor. By applying new taxes at too high a rate, and too soon, the Soviet Government runs the risk of stifling cooperatives rather than encouraging them. This needs correction.

7. Tax Exemptions and Preferences

Apart from regional tax rate differences, there is, of course, a strong theme of social activism in Soviet society. It predictably expresses itself in tax policy for cooperatives. Exemptions or tax preferential treatment are given to cooperatives for activities considered to be socially worthwhile. Medical cooperatives are taxed at a low rate. Cooperatives that employ or minister to invalids, other disadvantaged persons or to children, receive favorable tax treatment. This differential is not only a fact of life in all taxing jurisdictions, but also is desirable.

The production cooperatives reviewed had a strong sense of social responsibility. It is probable that expenditures for social purposes, principally on behalf of employees, are proportionately greater in production cooperatives than in State enterprises. For one thing, cooperatives see their social welfare contribution as one means of justifying their existence to the public on whose approval they may ultimately depend for survival.

Plastics Center Cooperative, as an example, has determined that it will retain 30% of its after-tax profit for expansion and other direct business purposes and will pay 70% of it into its social funds.

In at least one case, Low Voltage Equipment, the current tax rate has been assured not based on purpose, but on other considerations. In this case, the present tax rates, at 28% are, per contract, extended to 1990, concurrent with the Cooperative's operations under the current five-year plan.

8. Comparative Tax Structures

VAT taxes in the European Economic community are computed under the same basic definition as in the Soviet Union. The tax rate in these twelve countries ranges from a low of 10% to a high of 23% with the rate for the major economic EEC powers ranging from 14% to 19%. This is lower than what is apparently intended under the new Soviet tax law.

9. Entrepreneurial Initiatives

All the above tax considerations are important to the future welfare of cooperatives. All of them represent possible impending difficulties that have the potential to stall the movement. Keeping taxes at a viable level is therefore of the utmost importance. The balance that must be struck is a tax rate and structure that should not be so low that this one class of society is not bearing its share of government costs. On the other hand, it is even more dangerous to have it so high that it destroys or seriously dampens the vitality and growth of the movement. As will be suggested in Chapter III, Conclusions and Recommendations, it is believed that a proper balance can be struck.

Despite this line of argument, there is reason to have great faith in the ability of entrepreneurs to survive and prosper. Given a tax system that is supportive of them, even approximately reasonable and one that eliminates statutory uncertainty for a reasonable period of time, entrepreneurs will adapt and flourish. The best proof of this is the vigor of the present cooperative scene, given the fact that the Soviet Union has not had experience with entrepreneurship for 70 years, and in modern industrial terms, not at all.

Key issue #8: What restrictions, if any, should there be on membership vs. non-membership?

In theory at least, the business of the cooperative belongs to its members. "Business" does not refer to the property or to certificates of rights of ownership. In the industrial West these would be shares of stock, a concept largely foreign to the Soviet Union, not a subject of general discussion nor one for which it is ready. Instead, it is meant again in theory at least but with important limitations in actual practice, that the members have the right to decide what to do with the proceeds.

It should be noted that another Western concept is at present a significant element in the Soviet Union. This is the Western economies concept of dividends, a distribution of profits that is "semi-guaranteed" for as long as it is fiscally responsible to do such dividends, usually in cash, to rise in rough relationship to an increase in profits. In the Soviet Union, owners (or more specifically, workers, whether they are owners or not) can earn substantial bonuses in response to supervisory judgement of their individual performance. But the concept that their membership status per se entitles them to some proportionate share of profits, i.e., a "dividend," is not a developed concept.

One reason why this is so is perfectly natural. When asked what should be done with residual profits, cooperative managers, without exception, cite the need to plow them back into the business. In some cases, the Board or membership has earmarked proportionate distribution in advance. Given the growth currently being experienced, there can be no other answer at present.

As an aside, it is interesting to note that whereas Western practice typically relates profits to sales revenue, the ratio most frequently cited by cooperatives in regard to profits was its relationship as a percent of payroll.

The difference between "members" (i.e., owners) and "contract workers" (i.e., non-members) is relatively slight in actual practice. A contract worker does not accumulate vacation and holiday pay or certain other fringe benefits available to members. (Note that most cooperative members do not yet accumulate any pensions, compared to the small pensions available to workers in SOEs. Note also that there is a distinction between fringe benefits, which in the end are cash payments, and perquisites such as availability of recreational facilities).

The cooperative movement is sometimes subject to restrictions on contract labour as a percent of members. In some cases, and especially in some geographic areas of jurisdiction, there is no restriction on how many contract workers are employed. The experts were told that this is the case in the majority of instances. But specific cases are known where the number of contract workers may not exceed one in three, one in four, one in five or one in ten and at least one case where the ratio has been progressively tightened. There are also locations where the restriction takes the form not of a quota but of a tax penalty. This seems to be a consequence of governmental concern to prevent excessive employment shifts away from the SOEs. This appears especially to be the case in the crowded Moscow and Leningrad areas. It may also represent an ideological concern against "worker exploitation."

It may be that initially at least, restriction on non-member workers reflected an intention to extend the benefits of membership in a cooperative to the majority of workers rather than allow only a small number to control the cooperative and benefit from its results.

Key issue #9: What restraints are needed on the present almost absolute operating authority of the Executive Director?

1. Organization Relationship

There are a number of organization relationships describing actual practice in moving from the top of the organization chart through the ranks of supervision and staff to the ranks of direct labour. The structure is, of course, more complex the larger the production cooperative.

The key role in every cooperative that was encountered is that of the Director, i.e., the Chief Executive. In every case where the director or members of his staff were asked to draw a chart of top level relationships, they gave the same responses:

1. drew the Executive Director first, alone in a box at the top of the chart,
2. drew the Board of the Membership (where there was one as described below) in a common box under, and reporting to, the Director and
3. did not itself identify itself the membership as a command entity at all, although when questioned, they agreed that in theory, it held authority over the Director.

The full membership holds regularly scheduled, but infrequent, meetings. Not more often than once a quarter is the interval in a cooperative of any size. Meetings of the membership are in toto. Meetings of the Board are more frequent, although not always regularly scheduled. In every case encountered, the Board consists of a small number of persons exclusively made up of the key members of management. They are appointed by the Executive Director, as consequence of the importance of their position and not as a random representation of the membership. In reality, therefore, they are the "management" and the agenda of their meetings shows that they are typical of top level staff meetings in the West.

In case of the largest cooperative reviewed, it had been found necessary to have an intermediate group representing membership because of the natural inability to conduct business in depth with a group of over 2000 people. This group meets quarterly. It is composed of about 180 people, elected by the members. They review major management actions or intentions, particularly major capital expenditures. In general, the staff and supervisory structure reporting to the Executive Director is not unlike that in the West. No examples were encountered where anyone short of the Executive Director had full operating responsibility across all the cooperatives' activities. In general, the #2 person in the cooperative was often the Chief Engineer; the #3 person the Accountant.

The membership of cooperative banks is different and as a result the management governance structure differs as well. See the separate discussion of this previously.

2. Who Started the Cooperative?

There appears to be a definite pattern in the profile of Executive Directors. Recognizing there was no case where a cooperative was yet two years old, in every case, the Executive Director was the principal original founder of the cooperative and still its guiding genius. Typically, he was young (around 40 or under) well experienced technically and educationally, and definitely of an entrepreneurial turn of mind.

3. Authority of the Director

Given this background, it is not surprising to learn that in most cases the original founder - now Executive Director - is still in charge. The owner-Executive Director thinks and acts very much as one would expect his counterpart in the Western economies to behave. He is very much in charge and indeed thinks of the cooperative as "his". Especially over the long pull, as will be discussed under "Recommendations", there is a concern about the relative lack of restraint on his authority and on how the eventual inevitably necessary transfer of power is to be effected.

Key issue #10: Is more public support of the cooperatives needed and how should such support be generated?

1. Public Attitudes

The cooperative movement is stated to be not popular with the general public. It is difficult to judge the extent or true reasons for this. It seems to be centered on the perception that cooperatives (and their employees) are making very good money, which is generally true, and that they are accomplishing this by unreasonable price gouging. At least as far as production cooperatives are concerned, the latter does not appear to be true. On the other hand, it is true that cooperative restaurants charge a very high rate relative to the rates charged by the SOE restaurants. (In one personal experience, the dinner meal cost in a Moscow restaurant was over 13% of the country-wide average monthly wage). The average citizen probably does not know enough about the different kinds of cooperatives, production cooperative vs. a small service cooperative, to make a distinction between them. Undoubtedly, elements of envy, of problems with recently accelerating inflation, and a long-time lack of familiarity with the basic elements of the profit system play their part in this perception.

What it means is that entrepreneurship, often admired in many different types of economies, does not necessarily translate into public support for cooperatives in the Soviet Union. Politicians everywhere know and respond to their perception of where public support is strong, not interested, or antagonistic. A greater effort to generate public support of cooperatives is therefore essential to their future welfare.

Key issue #11: What are the longer term merits of decentralizing government control over cooperatives to the local level?

In other countries, cooperatives are registered with designated government agencies and are regulated by uniform standards and procedures. Each cooperative has a unique charter and by-laws that must comply with government regulations, but there are not negotiated contracts as such.

1. Strong Local Orientation

By contract, every Soviet cooperative has a governing body as overseer. Many of the rules by which the cooperative must operate are set by this overseer. Many of the work rules are set by this overseer.

Some of the cooperative contracts are arranged with National Government ministries. Some are with Republican Governments. But most of them are with local soviets and recently announced national government policy on decentralization supports further orientation in this direction.

Soviet tax policy also points increasingly in this direction. Up until now, despite some important tax exemptions granted, the statutory cooperative tax rate, at 2% to 10%, has been so low that the question of the focus of governmental influence was relatively unimportant. But with the tax now due to increase, this issue becomes of greater importance. This is especially so since the allowed range is 5% to 60% with the base rate to be decided by each republic and the actual individual rate after exemptions to be set by the local soviet.

2. Contracted Parties

It is important to recognize that the authority for each individual cooperative resides in a contract. The contracts differ importantly in detail as a result of the individual negotiations that took place in setting up the cooperative.

Who is the other contracting party? It is estimated that the total under local authority is well over 80% and this trend is increasing. The Soviet economy, heretofore always highly centralized, has decentralized this relationship, almost to a fault.

3. Factors Allowed

It is understood that republics may set tax rates based on eight factors, local soviets may consider six, essentially the same factors. These consist of such factors as types of activity in which involved, how important each is to the economy, how large the cooperative is, status on prices, status on ratio of members to contract workers, etc. This may be too many factors. Regardless, it seems apparent that local soviets have wide authority to set tax rates.

4. Granting of Differentials

Three aspects of this local option are foreseen that have potentially undesirable characteristics. First, regardless of what factors are or are not employed, it follows that in practice, the degree of tax concession granted will often be based on arbitrary factors or on attitudes rather than on economic logic. This is likely whatever the jurisdiction, but lack of comprehensive economic consideration is more likely at the local level. Second, experience shows that different local bodies will apply their judgements to suit their particular agendas. In other words, some areas will opt for economic growth and will fashion tax incentives to achieve it. Other areas will be more interested in the reverse, containing growth, in the interests of, for example, ecology. In response, cooperatives will naturally be influenced accordingly in their choice of location by these incentives, but making operating decisions based on momentary tax advantage is not usually sound economics.

5. Potentials for Abuse

Third, proper governmental control over cooperatives ideally strikes a proper balance between nationwide protection of law expressed in sufficient detail and also with allowance for discretion, particularly when conducted at the decentralized local soviet level close to the operating scene. As will be developed later, it seems that the indicated balance is not ideal. On the legal side, national laws are currently too brief and too general to provide adequate guidance and protection. It is understood that the original promulgation of the new tax code in March 1989 was half a page long. On the discretionary side, it seems that local soviets have been allowed too much discretion in a number of areas, and now in adjusting tax rates. When this substantial discretion is combined as it is with considerable power, the danger of abuse is considerable.

It is one step, although a delicate one, from this kind of abuse to another kind that is even more objectionable. This is the possibility that a cooperative has potentially too much opportunity to influence, or be influenced by, local government authorities. In the United States, speaking generally, one finds that where big decisions are played on a limited field, the opportunity for graft increases. In other words, in the aggregate, improper influence or graft is more likely to occur at a local level than at a regional level, and more likely there than at a national level.

Key issue #12: What kind of legal framework is needed to further the welfare of cooperatives?

The dangers of the contractual governance being at this local level have already been cited. This is further compounded by the "looseness" of legal support.

1. Nature of Laws

The following contrast has been drawn between Western economies and Soviet law. ^{12/} It is said that Western law specifies what cannot be done, with the clear understanding that anything not specified is permissible, whereas Soviet law specifies what can be done, leaving the party affected not knowing whether other practices are not permitted or whether they are at the very least in doubt. However harsh this judgement, there appears to be an element of truth to it as regards cooperatives. Soviet laws affecting cooperatives are typically short and general to the point of being vague. Specifics occur only at the local contractual level. Some redress of this balance is in order.

2. Need for Legal Protection

The need for a positive statement of the rights of cooperatives exists if only because they are entitled to have more legal protection than they do now. This is extended beyond their need for a more uniform tax codification into their simple rights to police protection of "their property" and some avenue of legal appeal from local governmental fiat.

3. Sending Mixed Signals

In addition to the absence or brevity of law, its vagueness is also a major fault. The Government, whether it intends or not, is sending mixed signals on whether it basically supports the cooperative movement or not. A clear signal is needed and should be sent now.

The response received when it was tried to initiate discussion with cooperatives on possibilities for dialogue between cooperatives and National or Republican Governments has not been encouraging. In general, except in the field of taxation, the need for such a dialogue was not even recognized. "The best thing they can do for us is to stay completely away from us" is a quote received from a cooperative Director. Unfortunately, it seems to be the prevailing attitude. Recognition of the need for such a dialogue and instituting it can be a major task of the newly forming Cooperative Association.

4. Ties to SOEs

Despite all this need for local regulatory consistency and national legal clarity, the informal relationships of cooperatives with the national and republican ministries should not be overlooked. They are not being overlooked by the cooperatives, especially those that have spun off from or still have and need operating ties to a parent, or former parent SOE.

Key issue #13: What are the prospects for cooperatives forming foreign joint ventures?

1. Current Condition of Joint Ventures ^{13/}

Joint ventures have been growing rapidly in the Soviet Union since 1987 when it first became possible to set up joint ventures. By the end of 1989, it appears there will be from 740 to 940 registered. It is also necessary to be certified to be involved in a joint venture and also to conduct international business. Such certification and registration is theoretically open to all. Nevertheless, closer inspection of their configurations is not encouraging to the idea that this is an important imminent opportunity for cooperatives, for the following reasons:

1. While there are some sizeable joint ventures being concluded, the majority of them are between fairly small entities initially anticipating modest initial revenues. Therefore opposite potential parties are hard to make contact with.

^{12/} Tedstrom: "New Regulations for Soviet Cooperatives" January 20, 1989.

^{13/} To keep up to date in this and certain other areas, see the periodic publication "Plan Econ Report", especially that of March 24, 1989 from which statistics and conclusions cited are drawn.

2. Negotiation with joint-venture partners requires expertise, experience and in general, production cooperatives do not have this expertise.

3. Only 15% of the number of joint ventures registered as of mid-January 1989 have been for consumer goods. (Although intermediate goods or component assemblies are undoubtedly not included).

There are a number of parties in the Soviet who can help the individual cooperative prospect for joint ventures. The now-forming Cooperative Alma Ata ^{14/} with its new branch bank in Moscow is already preparing to do so. This can be useful for both, banks and the Association. The Central Cooperative Bank of trade with Finland and the bank is seeking other opportunities. Cooperative banks in the Soviet Union are empowered to engage in international trade.

2. Lack of Foreign Exchange

More important than all the above considerations is the fact that joint-venture possibilities cannot be pursued under present conditions of currency inconvertibility. ^{15/} The prospects for such currency convertibility and the steps required to achieve it are beyond the scope of this report. In the meantime, for the foreseeable future, joint ventures have to be and are based on the principle of mutually advantageous barter. The exchange of raw materials for finished goods, running in either direction, does not seem especially promising in the consumer goods field. The possibility for barter of production equipment traded for end product or components suggests some possibilities. The fact must be faced that in many cases the quality of Soviet consumer goods excludes them from the world's more quality-conscious, more sophisticated markets.

As the previously discussed cost profile shows, Soviet cooperative goods are not fully competitive due to lack of mass manufacture in most cases and an uncompetitively high material cost due to the imposed mark-up system. Another possibility - not yet developed - is joint ventures that take advantage of lower Soviet wages, i.e., subcontracting of labor-intensive operations or drawback arrangements. In addition, there are the additional difficulties of tariff barriers.

3. Technology Objective

Of course, not all production cooperatives are confined exclusively to consumer goods. In the industrial products area, where generally there is more of a technological component, there may be somewhat more joint-venture possibility. For example, the outlook is considerably better for joint ventures for Micron and for Forpolymermach, the two most technological cooperatives encountered during this study and with the greatest uniqueness to offer.

In general, there is a technology objective to much of the joint-venture aspirations of Soviet firms. The more this exists, the greater the possibility of interchange and joint venture.

4. Advertising Approach

There is a process of assisting in an experiment to see whether the actual outlook might be more optimistic. Low Voltage Equipment Cooperative is assisted in making contact with the United States Department of Commerce and an advertisement was placed and directed at relevant small and medium sized companies who might have interest in becoming partners.

5. Eagerness of Inquiry

Despite all the above, during the Cooperative Congress a number of individuals approached the UNIDO experts proposing discussion on the possibilities of specific joint ventures. Many

^{14/} Case study issued as document ID/WG.498/6(SPEC.).

^{15/} The Bank for Foreign Trade (Vnesheconom), part of the State Bank system, does provide some convertible currency for approved foreign trade transactions.

of these discussions were impractical or misdirected. Nevertheless, the mere frequency and enthusiasm of attention suggests that a more productive way to conclude joint ventures may be uncovered by cooperatives, especially over time.

Key issue #14: What is the mission of the Cooperative Association only just now emerging and what should be its guiding principles for maximum effectiveness?

In the course of this study of cooperatives involving attendance at the Cooperative Congress, participants asked to analyze the proper duties and structure of the emerging Cooperatives Association. This issue addresses these questions.

1. Traditional Functions of an Association

All associations are organizations created to serve their members. In at least a broad sense, therefore, the missions of all associations are similar. In the United States, we identify the following broad purposes as common to almost all associations; these are in no particular order:

1. Provide members with services and information.
2. Conduct public relations and press relations on behalf of the members' common concerns.
3. Take official positions on relevant issues that represent a consensus of the members' views.
4. Help advocate these positions or individual members' concerns to governmental or other bodies having influence or power over members' welfare.
5. Conduct research, assemble statistics and prepare reports and periodicals in areas of members' common concerns.
6. Provide a forum where members can meet with their opposite numbers in the association and with others who have concerns in common areas.
7. Sometimes, but not always, conduct training sessions to further member education on relevant subjects.

2. Special requirements of Association for Cooperatives

In addition to the above, certain needs of potential members have been identified that would certainly be apart of the mission of any cooperative association created:

1. Start by bringing such an association into being.
2. Study the need for legislation at the national and at the other governmental levels, clear conclusions with the membership and represent them to appropriate governmental personnel.
3. Study the proper configuration of taxation at various governmental levels, clear conclusions with the membership and represent them to appropriate governmental personnel.
4. Assist members with advice on appropriate terms of contract and on loan instruments.
5. Study and draw conclusions on optimum relationships for production cooperatives with SOEs and advise members on findings.
6. Provide members with general consultancy services on relevant topics.

7. Study price positions of members and conduct public information campaigns to change unfavorable public perceptions of cooperatives.

8. Conduct general public awareness campaign to disseminate increased public knowledge about cooperatives.

9. Provide staff and temporaries to train members in skills commonly needed by cooperatives.

3. Ties to Government

A Cooperative Association will be the principal organ of representation and contact with the Government for the cooperative industry. It should create its own independent ability to further mutual understanding between member cooperatives and government offices and the government bureaucracy.

4. Ties to Supreme Soviet

A Cooperative Association should also be the political arm of the member cooperatives. It will need to build political recognition. One of its most important objectives therefore is to create a voice that the Supreme Soviet (and other soviets) will listen to.

5. Representation in Government

A question much under potential member discussion is whether key figures in associations should by rights have some governmental elective offices reserved to them as a means of advocating the needs of cooperatives within political bodies. One suggested means of accomplishing this would be that a certain number of seats in the Supreme Soviet and certain other lesser elective bodies be "reserved" for cooperative representation. If this can be attained it is desirable. It is consistent with the Soviet idea of providing economic blocs with political representation. However, the cooperatives should not rely on this as their only or even their primary means of protection.

6. Freedom and Organization

The recent Cooperative Congress was truly an exercise in democracy. The degree to which delegates spoke their minds and forcefully presented their various points of view was most impressive. In fact, such a high degree of freedom of expression prevailed that at times it seemed as if the minimal necessary work of the Congress (appointing committees, reviewing their findings, adopting by-laws, etc.) would not be completed. With a large congress of 650 delegates and at this early stage in the Association's formation, this is understandable. The reason for mentioning it here is that at some point in its formation and operation the evolving Association will have to take a firmer disciplinary stand even at the risk of being less democratic in order to take charge and get its work done. It is to be noted that "People's Deputy" Tikonov made essentially the same point.

7. Qualifications for Director

It is reasonable that a Director of the emerging Association should be named as early as possible. The Director should be well paid. In addition to many other reasons for this, it should be kept in mind that directors of the more important cooperatives are, by Soviet standards, wealthy men. They must look on their Association Director as their equal in every respect. Beyond the obvious personal characteristics of excellence, there is another qualification that is important. The Association Director should be fully able to move in political circles and he or she should bring political importance with him or her, or at least have the ability to create it. A person who is otherwise well qualified and who moves in respected political circles is a better choice than a person who has no familiarity with politics.

8. Varying Attitudes

It was noted at the Congress a tendency for delegates from areas or republics with special objectives to attempt to bend Association by-laws and procedures to serve these other objectives. For example, delegates from the Baltic Republics want the rules fashioned so that association membership clearly furthers the cause of nationalist aspirations of that area. Azerbaijan wants membership eligibility to extend beyond the Soviet borders. This would serve their objectives of ethnic cohesion. Such objectives must not be permitted to predominate because there are already enough divisive tendencies. Various constituencies have enough different objectives anyway so that there is real danger that what is starting out to be a single association will fractionate into a number of associations each representing a separate special interest. Multiple associations will not have the authoritative voice or the power balance to make them effective representatives to regulatory bodies. Multiple associations may not develop a sufficient dues base to make separate rival associations financially efficient.

In any case, there are already several cooperative associations at the republic level as well as a National Association of cooperative banks. A national apex Cooperative Association representing all cooperatives in the Soviet Union, seems to be both, an issue and a fundamental need.

III. CONCLUSIONS AND RECOMMENDATIONS

Key issue #1: Where does the greatest future prosperity and growth for cooperatives lie, with cooperatives that are sponsored by an SOE or with those that are fully independent of such a relationship?

Production cooperatives (like all cooperatives) have a tough road ahead of them. They live in a world dominated by SOEs, many of which are or potentially will be their rivals. This will undoubtedly be the case for some years to come. No matter how fast cooperatives grow, the mainstream of industry will, for some time, be designed primarily around the needs and convenience of the SOEs.

In a world of this sort, production cooperatives need all the help they can get. It is observed that most relationships between production cooperatives and the SOE that they came from are entirely cordial. Such a sponsor can be a powerful ally.

The fact that an estimated 80% of all production cooperatives came from such a history suggests that there are dynamics at work that favor healthier, better initial growth with such a sponsor than without one. There is no reason to fight this trend and every reason to take advantage of it. The government would help the cooperative movement in a proper way if it encouraged this trend. It could do this, for example, by allowing partial forgiveness of probably unrecoverable debt as incentive to such a spin-off. The Cooperative Association being formed should investigate ways to facilitate such sponsorships.

However, in the longer run it would be better if cooperatives were fully legitimized within the system rather than having their dependence on SOEs indefinitely perpetuated.

The fact is that both historical origins exist and will continue to. There is not necessarily a conflict between them. As cooperatives grow in importance and expand in areas of activity, materials, goods, and services will become increasingly available to them from private sources outside the present structure dominated by SOEs.

With service cooperatives it does not seem that it matters or that this issue is necessarily relevant. As long as a cooperative restaurant, for example, has a dependable source of food, it does not need a state-owned sponsor.

It is interesting to note that the sample suggests that many cooperative directors do not philosophically favor the SOE connection. For them, it is both the above-mentioned feeling that they deserve to be fully accepted within the system coupled with an emotional conviction that "pure" individualism, untainted by association with the State, is ideologically preferable.

Key issue #2: What is the best approach for providing smooth operation for cooperatives under conditions of materials shortages?

Freedom of operation is much harder to put into effect under conditions of material shortage because whatever additional freedoms are allowed may result in substantially increased inflation. The full economic consequences of whatever additional allocations are made not only have to be thought out carefully, but will necessarily take longer to put into effect. It is suggested that cooperatives gradually have their disadvantage in the area of shortages and allocation removed from them. This can be accomplished by allocating each year a certain portion of the total of certain commodities to cooperatives, increasing the proportion gradually each year. Better still, these commodities can be deallocated over several years in a planned and committed program. Emphasis can be placed on priority production, perhaps by cooperatives themselves, of shortage goods.

Such a program can be experimented with by singling out certain commodities, subjecting them to such treatment, and carefully observing the effect. It is suggested that such experiment start with commodities not so subject to shortage. Lumber is an example. Lumber distribution could be decontrolled or perhaps gradually the whole construction supply industry. Another way to introduce such experiments on what would initially be a more controlled basis would be to confine them to certain republics only. This has certain cross-border ramifications, but has nevertheless been successfully executed elsewhere in the world.

Key issue #3: Can credit be more efficiently supplied and utilized?

The provision of credit for cooperatives was not found to be a problem of the magnitude expected, especially given the fast growth being experienced by them. Part of the reason for this is the sponsorship and help coming from SOEs in many instances. Part of it has to do with the rapid payment practices employed, which minimize credit requirements despite high revenue growth rates. It is expected that inventory turnover rates will improve somewhat with growth and with some hoped-for improvement in shortage situations. Since direct price competition at retail and wholesale levels is some time away, profit margins are not expected to decrease if labor productivity and revenue growth hold up.

There has been some slowness, not for major seriousness, in banks making credit available to cooperatives as customers. The new creation of cooperative banks will help in this regard. It should be made clear that cooperatives are not to be relegated to a secondary priority when banks grant credit. This applies especially to state banks. It is recommended that public debt forgiveness be incorporated as part of future cooperative contract conclusion and that it be more liberally applied.

Key issue #4: Should control over fixed assets evolve into ownership or lease and what term of lease? Does ownership or lease of land and buildings and equipment need to be further assured?

The need for establishing ownership of fixed assets or any corporate property only exists when there is need to transfer ownership to persons not currently employed by the cooperative. While creation of such a right may be desirable some time in the future, it is not an urgent need for cooperatives in the Soviet Union at the present time. Therefore, while ownership should be both legal and acceptable when cooperative members wish it and can afford it, there is no necessity to promote it as preferable. Leasing fixed assets can continue to be entirely acceptable.

On the other hand, there is a longer range concept that should be kept in mind. In time, a principle of ownership that is distinct from being an employee will emerge even though it is a concept not compatible to Soviet business today. If and when this distinction emerges, ownership in the business and ownership of the underlying assets will become a key issue.

In this connection, it is understood that the newest form of organization developing at this time is the private corporation. They do not yet have legal authority, although it is understood that this is a near-term possibility. Only a small number of them presently exist. The essential difference between a private corporation and a cooperative is as follows. The cooperative is member-oriented, "one member-one vote". Voting power in the private corporation (as with Western corporations) is based on shares - the number held. This development bears watching. For one thing, it could eventually represent another turn in the road for private control of enterprise. It would not, for one thing, suffer from the cooperative's bad public image.

It is important that leases be assured for a reasonable period of time if reinvestment is to be fully encouraged to the maximum. Reinvestment should be encouraged because it is the best way to maximize the productivity of assets and one of the best ways to encourage the cooperative movement. Many in the cooperative movement say they are not concerned about operating on a lease unassured as to tenure. It has to be believed that the prevalence of leases with no assured term necessarily exercises some inhibition on major reinvestment. Furthermore, if cooperatives, during some future time of general economic troubles, start to run into difficulties, the possibility of peremptory foreclosure of a lease could present real problems.

It is understood that the open lease has been, until now, with the possible advent of increased taxation, almost the only control weapon that the local authority or other government contracting agency has had over the cooperative. Notwithstanding this, a restraint arbitrarily available or arbitrarily applied is not economically wise.

Longer terms leases are already legal. It is recommended that contracting local soviets be instructed to volunteer lease assurances of at least three to five years retroactively effective July 1, 1988. Much longer lease terms seem appropriate when major investments in buildings and equipment are involved. The principal lease terms must be long enough to give reasonable assurance that an adequate return on investment is possible.

With regard to land, this is the only asset where ownership is not allowed and there is no obvious reason to change this at present if term leases are applied to both land and buildings as recommended above. In fact, permission for land ownership is not necessary for the encouragement of the cooperative movement and it could actually have a bad effect just at present. Under today's conditions of high inflation, the transfer and pricing of urban land values could have a highly inflationary effect.

With regard to buildings and equipment, the question is answered above. Some of the less expensive equipment leases could be for a shorter period but not for less than one year. It is also possible and easier to purchase such equipment outright. Ownership of computers, for example, is not uncommon.

Key issue #5: What is a wise pricing program? What profit configuration seems advisable and likely?

As discussed above under taxes, the substantial mark-up through application of high taxes on material to cooperatives only is a bad tax that should be discontinued. Having this high a wholesale mark-up is also bad pricing policy.

Removal of price controls would be inflationary under present circumstances and cannot practically be adopted now given the widespread pattern of shortages that prevails. However, price controls are bad for an economy and generally don't work. They should be removed piecemeal wherever this can be done and especially in areas where there are not shortages.

Except for requiring cooperatives to price way over cost as per above, the present profit structure for cooperatives is appropriate to the early stages of cooperative development and is likely to continue unless the Government, through tax policy changes or otherwise, makes mistaken attempts to change it.

Key issue #6: How can the Soviet Union best capitalize on the labor productivity of cooperatives? Does this productivity justify the higher pay of the cooperatives compared to SOEs?

The pass-through by production cooperatives of some, but not all, of their superior productivity to wages is none of the bright spots of the cooperative movement. Nothing seems to be wrong with paying cooperative workers substantially more than their SOE counterparts, providing higher profits are maintained and that the opportunity to lower sales taxes and pass some of the productivity gains along to consumers is also developed and implemented.

Key issue #7: What is the proper taxation program for cooperatives?

Taxation programmes typically require especially detailed study and lengthy negotiations with legislators. Nevertheless, it is recommended that as soon as possible, the Supreme Soviet incorporate tax instructions more detailed at the national level and incorporate these into law for forwarding to republics and local soviets for implementation. The law would be along the following lines:

1. A Supreme Soviet-decreed tax rate on value added of 20% to 25% is about the right level of taxation for producing cooperatives if certain further tax reduction options are also applied. Which number within this range to select depends on the degree of encouragement that the Government wishes to give to the cooperative movement. A rate of 30% or more would be a depressant and should not be provided as an option.

The Supreme Soviet or possibly each Republic should set guidelines and mandate certain ceilings with further reductions, as below, permitted to local soviets. The ensuing economic competition would be good for the cooperatives.

2. Local soviets to be permitted to grant up to 10% additional exemption, not more than 5% for work for charitable or other socially worthwhile purposes and all other exemptions to be limited to to 5% so that the net tax at this point could not be lower than 10% to 15%. Note that this net rate is entirely consistent with the prevailing rates in the EEC cited earlier. Tax rates could be allowed to be higher for service cooperatives where there is no value added.

3. It may be desirable to graduate this tax for smaller cooperatives to encourage small business and to make some allowance for their possibly higher costs.

4. Assurance of continuity to be supplied by commitment that these tax rates be valid for five years. Of course, it is assumed that any law can be cancelled by a subsequent law to the extent doing so is not unconstitutional, but revoking these tax rates should be made as difficult as possible and be only for the purpose of correcting for some unforeseen major change.

5. In addition, to encourage reinvestment by cooperatives, there should be an investment tax credit tied to the amount of eligible investment made but not to exceed 20% of the total tax amount due.

6. Separately, the cost mark-up tax raising wholesale prices for cooperatives is a bad tax. It is a hidden tax, contains a discriminatory differential and is highly regressive because it is passed on in the form of higher consumer prices. It should be phased out over a five-year period with the proviso that the amount of tax relief be passed through to the wholesaler and consumer in the form of lower prices in equal amount.

Key issue #8: What restrictions, if any, should there be on membership vs. non-membership?

From within the cooperative, there appears to be relatively little concrete difference in being a member compared to being contract labour. There is the question for minor differences in pay, holidays and some fringe benefits. The most important difference seems to be the right to vote. In many of the large cooperatives, this doesn't seem to make much practical difference. But there probably is an important difference just the same, and that is a psychological one. There is considerable psychological advantage to the feeling of being a member, one that the movement ought to be permitted to take advantage of as a potential morale builder.

Membership in a cooperative should be open to all those who are committed to its purposes and who meet the criteria stated in its charter.

Priority in advancement from non-membership to membership status granted to the most productive non-member workers can be a powerful productivity incentive.

The argument has been raised that the restriction stems the flow of workers toward cooperatives in labor-short areas. This argument is rejected by the experts; why shouldn't workers move in a direction where they would be more productive? Moreover, the number of workers theoretically restrained from moving by these restrictions where they exist has to be small enough not to make a major difference. Even with the restrictions, workers wouldn't necessarily be restrained from moving to work in cooperatives anyway. The rule's principal effect is one of harassment. Similarly, the contention that the rule prevents worker discrimination also has no practical effect. It is recommended that this should be dropped by national instruction to the republics and municipalities.

Key issues #9: What restraints are needed on the present almost absolute operating authority of the Executive Director?

This is a complicated issue, made all the more complicated by the fact that it is not yet a major problem and it is not recognized as a potential problem, least of all by the Executive Directors themselves.

But it can become a problem in time. As cooperatives grow and get larger and as Executive Directors get older, some of them will lose competence without their admitting to it.

There are only two parties that have the competence and authority to remove or restrain an Executive Director: the Board or the entire membership. For any membership more than about 25, the Board, despite its being less than an ideal instrument, is the best way to provide for any needed removal of an Executive Director. Realistically, the Board is less than ideal for this purpose because its membership is created by the Executive Director and the Board members' jobs depend in the last analysis on his favor. The circumstance would have to be extreme for the Board to register a negative vote under such realities.

The fact that there are less restraints on unjustifiable continuation in office for a Soviet Cooperative Executive Director than there are for his capitalist opposite number. We consider this not healthy in the long run. Key issue #12 discusses the merits of a Corporate Governance Law. If such a law were to be enacted, it might well write in Executive Director removal proceedings and any other needed restraints, if only to give them the symbolism of strength of law.

Especially as cooperatives mature, the Executive Director should be appointed by and responsible to the Board of Directors elected by the general membership.

Key issue #10: Is more public support of cooperatives needed and how should such support be generated?

Any comprehensive program is in itself a subject for separate study since a program must be problem-specific rather than general. Another guiding principle is that the program should be closely tailored to Soviet conditions rather than an "imported" campaign from abroad. It is best supervised by the emerging Cooperative Association. It should be further observed that correcting a negative impression is much more difficult than enhancing a neutral or positive public opinion.

Key issue #11: What are the longer term merits of decentralizing government control over cooperatives to the local level?

Decentralization of government control is a move in the right direction and it is not suggested that any recentralization to make control over cooperatives more centralized should take place. Nevertheless, in the absence of overall policy guidance, decentralization has gone too far. It is suggested that this

be corrected by redressing the balance between centralized legal specification and decentralized implementation. This would be done by writing more specific detail into national (i.e., Supreme Soviet) laws as recommended in key issue #13 and by narrowing the degree of latitude now possessed by local governing bodies in various specific issues, for example the degree of latitude allowed both the republics and the local soviets on taxation rates under the new taxation law.

Key issue #12: What kind of legal framework is needed to further the welfare of cooperatives?

More detailed laws are needed at the Supreme Soviet level, (i.e., the national level) in the following areas:

1. There should be a law providing for the rights of the membership and distinguishing between these rights and the rights and prerogatives of the management. Further distinction should be made in law between the method of election of the board and its rights and duties and the prerogatives of the Executive Director. Among other things, this delineation of duties would deal with the mechanics of the succession problem in cooperatives. It should be clear that within the limits of duties reserved to the membership as a whole and to the Board, the Executive Director is responsible for managing the cooperative.

in the United States, the question of whether these methods of operation should be spelled out in law is much debated and is referred to as the "corporate governance" question. For a variety of reasons that are not pertinent to the Soviet Union, such a law, wisely, in the experts' opinion, has never been enacted there. But for reasons of needed cooperative protection and for needed clarification, it should be enacted in the Soviet Union.

2. A law that, in general terms, gives strong Supreme Soviet support to the cooperative concept. It should spell out what things the cooperative may not do and should make clear that except as mentioned (or periodically amended in law), cooperatives are free to engage in all other activities.

3. A taxation law as already recommended. The same law would state in somewhat more detail the criteria republic and municipal soviets are to apply in granting further tax reductions within the limits specified. The intention to equalize tax treatment and methodology as between cooperatives and state-owned enterprises should be included.

4. A law stating that decentralization will be the governance principle for cooperatives. This law should also set up rights of redress for cooperatives in circumstances where they believe local soviet rulings or treatment has been arbitrary or unjust and will cause them significant injury.

5. It is understood that a law on banks (including cooperative and commercial banks) has been drafted and is being reviewed with the expectation of it taking early effect.

Key issue #13: What are the prospects for cooperatives forming foreign joint ventures?

The Government should encourage foreign joint ventures with cooperatives, at least with some of the larger production cooperatives. The experiments in cooperation on the part of the Government and selected cooperatives should continue to be attempted. The Cooperative Association, when formed and operating, can assist in these efforts.

It should be recognized that, at least at the outset, prospects that there will be a significant number of successful joint ventures concluded early are not good. The principal limitations are brought about by overall conditions in the Soviet Union, such as the lack of convertibility into hard currency funds.

Key issue #14: What is the mission of a Cooperative Association only just now emerging and what should be its guiding principles for maximum effectiveness?

The principal proposed functions and activities of the proposed Cooperative Association have already been described. There are some other issues that will confront the Association as it makes its initial attempts to organize. The comments on them follow:

1. The Association has the choice of organizing on either a branch or regional basis, that is, it can group the individual cooperatives that are joining by trade or by geography, i.e., by republic. Grouping by geography would make the cooperative groups more effective in dealing with their local soviets. Because so many of the objectives of the Association can only be accomplished in the political arena, a geographical form of organization would be preferable.

2. The question has been raised whether the cooperative movement should attempt to form only one Association or several. For one thing, the needs of the many varied kinds of cooperatives are different. Also, some regional or trade associations already exist. It has therefore been suggested that what is needed is a federation of cooperatives.

It is felt that what cooperatives need most is strong political impact. This means that the movement should decidedly aim to create only one Association so that it will maximize this impact. In fact, fractionation of Association representation into a competing series of special interests should definitely be avoided. This is said even while recognizing that the problems and needs of producing cooperatives are in many respects different from those of the service cooperative.

There are three actions that need to be taken first, the sooner the better. In sequence, they are:

1. An organizing committee should meet. It should promulgate and circulate for final approval the set of by-laws offered to the recent Congress, amended as decided at the conference. The organizing committee should probably be the same committee that drafted the by-laws.
2. The same committee should decide on a membership and fee structure. The fee structure is arrived at in the following manner:
 - a) The committee agrees on what the Association should try to do in the next year.
 - b) It decides in general what staffing is needed to make significant progress on the missions it has just selected and decides what the programs will cost. That is, it prepares a budget.
 - c) It determines an equitable fee structure to provide these funds and solicits membership on this basis.
3. Once it appears that it is safe to conclude that funds are going to be provided, the committee selects an Executive Director, who should be a person of high ability and should have stature with the members and politically.

In fact that person should have been approached informally at the very beginning and, having tentatively accepted, should be a member of the organizing committee from the start.

ANNEX I

THE COOPERATIVE MOVEMENT IN THE UNITED STATES

This includes a description of the unique aspects of United States cooperatives and their comparison to the cooperative movement in the Soviet Union.

Cooperatives in the United States have a large number of participating members (there are more than 85 million enrolled names; many Americans are members of two or more cooperatives). Cooperatives are a relatively small percentage of the gross national product. They are engaged in nearly all types of economic activity in all the 50 states. These cooperatives are democratically governed businesses in agriculture, marketing, purchasing, thrift and credit, electric power, housing, consumer stores, insurance, and a wide range of business and personal services. While most United States cooperatives are single-purpose small enterprises with less than 50 members serving a limited market area, some are regional and even national in scope with tens of thousands of members (e.g., Land of Lakes dairy products and Nationwide Insurance). Insurance, agriculture, marketing, housing, rural electric and credit cooperatives account for 90 % of all members. There are very few industrial or production cooperatives. The thousands of housing cooperatives are found mostly in large cities. United States cooperatives are registered with state governments (specific legal provisions vary somewhat among the states). They are subject to federal, state and local taxation as business enterprises, with some specific tax provisions and allowances because of their cooperative ownership nature.

United States cooperatives are governed by their general membership on a democratic one-member one-vote basis. In most states, cooperatives must have at least five founding members. In others, at least 15 members are required. General meetings usually are held annually with special meetings if and when needs arise. The cooperative adopts official by-laws setting forth its objectives and procedures. The membership elects a board of directors, including a chairman and other officers - usually serving three-year terms. The manager is appointed by the board of directors. Typically, the manager is authorized by the board to hire other management.

The essential difference between a United States cooperative and a United States corporation or other private enterprise is that the governance of the cooperative is based on "one member=one vote" rather than being based on amount of investment holdings. The essential difference between a United States cooperative and a Soviet cooperative is that in operation, at least so far, the United States cooperative is more actively subject to policy and general operating practices determined by the members.

United States cooperatives typically obtain financing through the paid-in capital of member shareholders, from earnings, saving deposits, loans from cooperative and commercial banks and credit unions and, in the case of some larger cooperatives, from bond issues.

Cooperatives in the United States usually voluntarily join state-level and national-level associations organized by the economic purpose of the cooperatives (such as agricultural, credit union, housing). These membership associations provide information, training and business services, and represent their members before government legislative and administrative bodies. There are at least 17 major United States cooperative organizations.

Many cooperatives are active in international trade privately through their national associations and through bilateral government programs. The major United States cooperative organizations provide technical assistance and training to developing countries. For these purposes, they have established staff within a board-approved operating plan and budget.

While there are no legal limits on the number of non-member employees, United States cooperatives tend to encourage membership and much of the cooperative's business is managed by its elected officers and members voluntarily serving on permanent and special committees (usually without salary or wages).

The financial integrity of United States cooperative enterprises is key to their success. Members elect a Treasurer and an Audit Committee directly (that is, independent of the Board of Directors). Annual audits by outside certified accountants are required. The cooperatives are legal entities with full legal and financial authority and responsibility as determined by pertinent laws and regulations of the state(s) in which they are registered and doing business as well as by United States laws.

The more prominent and internationally operative cooperatives are usually members of the United States Overseas Cooperative Development Committee (OCDC), based in Washington and members of the International Co-operative Alliance (ICA, based in Vienna) and the Committee for the Promotion of Aid to Cooperatives (COPAC, based in Rome).

United States and Soviet Union cooperatives have some things in common, including for example similar private enterprise objectives, being engaged in a wide range of economic activities, generally being small and serving local markets, being highly industrious with productive workers and owner/managers and being averse to government regulation and control and being in some cases interested in international trade. On the other hand, United States cooperatives enjoy a long uninterrupted history of supportive government regulations; of equal access to materials, labour and financing; of strong memberships exercising democratic control and actively engaged in the enterprise on a voluntary basis; of demonstrated financial integrity and economic competitiveness; and of benefiting from fair and equitable taxation, and a reasonably stable and predictable economic and political environment permitting prudent planning and investment.

ANNEX II

COMPARISON OF COST PROFILES OF COOPERATIVES AND SOEs AND FINANCIAL RESULTS FOR A TYPICAL PRODUCTION COOPERATIVE

Tables 1 and 2 set forth, pro forma, financial results for a typical producing cooperative. They do not represent any single case and are therefore illustrative only, but they are an accurate representation.

Explanation to table 1

The following assumptions have been made: A cooperative that in one year manufactures and sells 13,000 units at 100 roubles per unit and a SOE manufacturing and selling the same product. Because of the co-operative's greater efficiency, it produces 30% more product. It also is projected as doing so at a 35% greater labour efficiency.

Cost ratios were derived as follows:

1. Material equals 40% of revenue. This includes a 4 times mark-up. Therefore, SOE material cost per unit is 1/4 of the cooperative's.
2. Tax rate for the cooperative is shown as 2%, the actual former rate for the first year of operation, and also at 10% (of revenue less material) the recommended net new rate.
3. Profit after tax at 20%.
4. Labor = balancing figure.

Note that in this projection:

1. Net profit rate to sales is coincidentally the same after the higher new cooperative recommended tax.
2. Cooperative pays more tax despite higher tax rate for SOE. This is principally because of cost mark-up tax.

Explanation to table 2

Growth rate of cooperative in second year is assumed a conservative 50%.

Efficiencies are assumed as a result of growth and leverage against expenses. It is assumed that 20% of material cost and 20% of labour cost is fixed. Efficiency gains are assumed at 10% and 15%, respectively.

Different value added tax rates are shown, including the 5% that would have applied under the old law, the 10% recommended, and the 30% that is frequently mentioned as probable normal for producing cooperatives.

Cash requirements are assumed to be:

1. 6-months working capital, principally inventory, required for every rouble of annual sales increase.
2. 20% of every rouble of sales increase required for additional fixed capital. No account taken of depreciation.

Under these assumptions, note that profits accelerate rapidly despite increased taxes. Note, however, that increased taxes could cause a continuing cash requirement calling for continued borrowing. At this growth rate, a cash balance is struck right around the 10% tax rate selected.

TABLE 1

Table 1. Comparison of cooperative and SOE costs and profit statements

Factor	Cooperative Operation				SOE Operations				Comments
	# Units	Amt./Units	P/L	Taxes Pd.	# Units	Amt./Units	P/L	Taxes Pd.	
Sales	13,000	100	1,300,000		10,000	100	1,000,000		30% more units from Coop 40% of sales. Cost markup 4x
Material		40	520,000	390,000		10	100,000		Coop labor 35% more efficient
Labor		40	530,000			61	610,000		
Profit before tax			250,000				290,000		
Tax rate			2% : 10%				25%		
Tax amount			10,000 : 105,000	10,000 : 105,000			177,000	177,000	
Net profit after tax			260,000 : 145,000				113,000	113,000	
Profit %			20% : 11%				11%		
Total taxes paid				400,000 : 495,000				290,000	

TABLE 2

Table 2. Profit and loss and cash flow for a typical production cooperative, shown at different tax rates

Factor	Year 1	Year 2				Comments
	tax rate 2X	5X	10X	20X	30X	
Profit and loss						
Sales	1,300,000	1,950,000	1,950,000	1,950,000	1,950,000	Sale increase year 2 is 50%
Material	520,000	471,000	671,000	671,000	671,000	
Labor	530,000	646,600	646,600	646,600	646,600	20% fixed cost efficiency gain 10% per unit
Profit before tax	250,000	633,000	633,000	633,000	633,000	20% fixed cost efficiency gain 15% per unit
Tax	10,000	66,000	132,000	264,000	396,000	
Net Profit after tax	260,000	567,000	501,000	369,000	237,000	
Total taxes paid	400,000	569,000	635,000	767,000	899,000	
Cash flow						
Profit After tax	260,000	567,000	501,000	369,000	237,000	
Working capital increase	(600,000)	(325,000)	(325,000)	(325,000)	(325,000)	Six months sales
Fixed capital increase	(260,000)	(130,000)	(130,000)	(130,000)	(130,000)	20% of sales
Net cash requirements	(\$600,000)	\$112,000	\$46,000	(\$86,000)	(\$218,000)	