



**TOGETHER**  
*for a sustainable future*

## OCCASION

This publication has been made available to the public on the occasion of the 50<sup>th</sup> anniversary of the United Nations Industrial Development Organisation.



**TOGETHER**  
*for a sustainable future*

## DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as “developed”, “industrialized” and “developing” are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

## FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

## CONTACT

Please contact [publications@unido.org](mailto:publications@unido.org) for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at [www.unido.org](http://www.unido.org)



18319

Distr.  
LIMITED

ID/WG.498/7(SPEC.)  
2 January 1990

**United Nations Industrial Development Organization**

ORIGINAL: ENGLISH

**Interregional Symposium on the Role  
of the Industrial Co-operative Movement in  
Economic and Industrial Development**

Moscow, USSR, 11-15 June 1990

**INDUSTRIAL COOPERATIVES AND SOCIETY,  
INSIDE RELATIONS AND STRUCTURE OF INDUSTRIAL COOPERATIVES,  
AND ECONOMICS OF INDUSTRIAL COOPERATIVE ACTIVITIES**

Discussion paper\*

Prepared by

P. H. Elicker,\*\*  
UNIDO consultant

4/10

\* The views expressed in this paper are those of the author and do not necessarily reflect the views of the Secretariat of UNIDO. This document has not been formally edited.

\*\* Center for Privatization, Washington, D.C., United States of America. The views expressed in this paper do not necessarily represent the opinion of the Center for Privatization or the Agency for International Development.

## CONTENTS

	<u>Page</u>
SECTION 1: Industrial Cooperatives and Society	3
SECTION 2: Industrial Cooperatives: Inside Relations and Structure	8
SECTION 3: Economics of Industrial Cooperative Activities	12

## SECTION 1: INDUSTRIAL COOPERATIVES AND SOCIETY

### Discussion

#### The Role of Industrial Cooperatives

In the Soviet Union a cooperative by law is an association of at least three people who decide to conduct business in any field where they see an opportunity, except for certain types of businesses that are prohibited.

Cooperatives were first authorized in November 1987 and the legal background was spelled out in law in May 1988. Since that time, they have grown very rapidly, as the following table indicates:

<u>DATE</u>	<u>NUMBER OF ACTIVE COOPERATIVES</u>	<u>NUMBER OF PERSONS EMPLOYED</u>
January 1, 1988	13,900	155,800
April 1, 1988	19,500	245,700
July 1, 1988	32,600	458,700
January 1, 1989	77,500	1,396,500
July 1, 1989	100,000	1,500,000

Growth is still accelerating and it is estimated that by the end of 1989, revenues will be 17-20 billion roubles from more than 160,000 active cooperatives. Typically a cooperative is small: the average membership is 15 persons. Those who join in the cooperative are "members." After collecting the revenues and paying all costs including taxes, the membership is entitled to keep the profits and dispose of them however they wish.

There are two kinds of cooperatives. Of the present 160,000, approximately 75% are service cooperatives: retail establishments serving the public directly. The three largest kinds are restaurants, automobile repair shops, and retail shops.

However, the other 25% of cooperatives are industrial cooperatives, those that make a product or provide a technical service. It is this kind of cooperative on which the symposium is focused. Again, typically, these cooperatives are also small but some of them, the more successful ones, have attained a size of as many as 4,000 employees.

The industrial cooperatives fill a place in Soviet industrial society. Compared to the state owned enterprises, they are more flexible and can take on miscellaneous tasks and production assignments in a hurry when needed. Many, but not all of them, are consumer oriented, producing products for that market.

While the movement is growing very rapidly, it should be kept in proportion. The revenues of all cooperatives represent only about 1% of the non-agricultural Gross National Product and the same approximate figure applies to employment in cooperatives.

### Regulation of Cooperative Activities

As the cooperative movement becomes an increasing percentage of the gross industrial product, the role of government should shift from that of direct control (over state-owned enterprises) to regulation (of cooperatives). Regulation by its nature is indirect. The basic object of regulation will be to enable government to achieve desirable state socialist objectives. As a matter of policy, the Soviet Government will want to move cooperatives steadily toward a goal of efficient servicing of both consumer and industrial needs, at fair prices, with a fair profit and with benefits available to all.

Regulation is a very different art from direct control and is its exact opposite. Regulation should not attempt to manage in detail but should confine itself to achieving broad objectives. The key element is that governmental regulation should be applied with a light touch rather than a heavy hand.

### Cooperatives Development and Restraint Factors

As set forth above, the dynamism of the cooperative movement is such that except as it is restrained, it should continue to develop and grow.

There are operative a number of restraint factors. Some of these are mechanisms that the state can consciously apply, either wisely or unwisely. Others are restraints inherent in the present state of the Soviet economy.

The principal state mechanism applied up to now has been taxation policy, as discussed further in Section 3.

The principal restraints imposed by the economy are the scarcity of goods, especially consumer goods, and the existence of widespread material shortages. Uncertainty of plentiful credit availability is also a restraining factor. So is the absence of an open, market-oriented wholesale market.

As a result, cooperatives have been perceived as operating under high prices and with socially undesirable discrepancies between empty shelves at the retail level when the state-owned enterprises are the producer, but ample goods at unaffordable prices from the cooperatives. Admittedly, this condition is more true of service cooperatives than of industrial cooperatives. Overall, this is a condition that the Soviet Government has pledge to correct.

### The Role of All-Union, Republican and Local Governments

The degree of governmental supervision over cooperatives at present differs considerably depending on the level of government.

At the all-Union level, supervision is very broad, and concerned more with general policy toward and the social role of the cooperative movement as a whole. Specific rulings at the all-Union level, in taxation for example, are similarly broad and brief.

The principal role of the republican governments is the determination of tax levels as they will apply generally to cooperatives in that republic.

Detailed control occurs primarily at the local council level. In most instances, it is this local authority that charters the cooperative at its initiation. In all instances, the specific tax rate, exemptions and other conditions to be applied to each specific cooperative are applied by the local council level. Informally, the local council can use its power to promulgate specific rulings as a means of insisting on a variety of cooperative behavioral requirements that they wish.

The expert team found the role of the higher levels of government to be too brief and too vague to install national policy effectively. By contrast, it found that local authority was in danger of exercising control over the individual cooperatives in too great detail. They also felt that too wide a range and latitude of diverse rulings available to the local council carried with it the danger of its power of governance being too arbitrary.

### State-owned Enterprises and Industrial Cooperatives

Industrial cooperatives operate in two very different ways, this often being related to how they got started. It is estimated that 80% of all industrial cooperatives are "spinoffs" from a state owned enterprise. Typically, a department of a state owned enterprise, or perhaps the entire enterprise itself is not able to meet its quotas or does not have the allocation to supply all of its activities with materials or equipment or, in extreme cases, the enterprise is failing. Under these circumstances, the state owned enterprise is often willing, for a price, to permit a group of entrepreneurs to become independent and operate the activity separately, no longer owned by the state but by the membership of the cooperative itself. In most cases, both the state owned enterprise that was the former owner and the cooperative find it useful to continue a close relationship. From the state owned enterprise's point of view, the cooperative performs useful work that cannot otherwise be accomplished. In the example already given, it sometimes specializes in fulfilling difficult quotas. From the cooperative's point of view, while it has legally the right to operate on its own, cooperatives exist somewhat outside the basic centrally controlled state owned system. Therefore it needs help in securing materials, buildings and equipment.

Many other cooperatives, however, are started up new. This is assumed to be the case with most of the service cooperatives; it is also true for a significant minority of the industrial cooperatives.

Inevitably, for such cooperatives, normal conduct of operations is even more difficult.

On the one hand, cooperatives grow faster if they have a helpful sponsor. But on the other hand, in the long run, this help may put off the day when government adequately protects and nurtures the cooperative so that it can make its way in the industrial world on its own.

### Legal Issues

In the governance of the Soviet Union in general there is, of course, a marked trend toward decentralization on all fronts. This is a significant and favorable development, and one that could not or should not be reversed. Decentralization is both from the national Government to the republics, but particularly a further decentralization to the local municipal council (soviet) level.

From the beginning, the enabling document for a cooperative is the charter permitting it to operate, with the local soviet usually being the contracting governing body. The drafting of these contracts and the provisions contained in them are individually tailored and as a result the local soviet has considerable control over the cooperative. The new tax law reinforces this tendency, giving a wide latitude to republics to set tax rates and local soviets to grant numerous exemptions. In most such cases, the discretion is very wide and covers too great a range. This trend, in excess, would have several dangers in it.

It opens up the possibility of economically illogical or arbitrary local decisions. It weakens any objective of implementing national policies. Beyond this, there is potential for outright abuse since each party at the local level has such a considerable ability to influence the other.

This looseness of legal interpretation is compounded by the fact that legal backup at the national level does not provide adequate support. In general, the national laws for cooperatives are too brief and vague in what they spell out. This results in sending mixed signals to the cooperative and does not provide it with adequate legal protection.

Both general legal statements of intent and specific directions are needed. Examples of the former are the need for a general law supporting cooperatives and a similar law supporting decentralization, but importantly including rights of redress for cooperatives from arbitrary local decisions. Examples of specific laws needed are laws spelling out the rights of membership as contrasted with the rights of management and the tightening up of the taxation law.

### Cooperatives and the General Public

Despite the economic vigor of the cooperative movement in the Soviet Union, it is understood to be unpopular with the general public. The reasons were not closely inspected by the study team. The bad reputation of the cooperatives seems, first of all, to come from a public perception of high profits attained through high pricing on the part of the cooperatives. This may well be true of the service cooperatives. Industrial cooperatives have a different pattern. Their prices at wholesale are the same as those of the state owned enterprises. Sometimes they are lower, very occasionally they are moderately higher. The state wholesale distribution channel is usually the industrial cooperatives' principal customer, although some may also sell at retail.

A second cause seems to be the simple human characteristic of envy. Cooperatives have done extremely well and their principal founders and managers have in many cases become quite wealthy. This stands out in Soviet society.

Worldwide experience shows that in any type of economy, politicians are not willing to be at variance with public opinion over a long period of time. It is therefore important that the program to change public perception of cooperatives is an essential element in getting politicians to support the cooperative movement with more active help. A Cooperative Association is being formed and the conduct of such a program is a natural activity for such an association.

Constructing a successful public awareness program is a complex subject that requires technical assistance. The program must be tailor made. It has to be specific and detailed as to what the problem is. It must be a program adapted to particular local conditions; if it is too general, it will be ineffective. Making a success of the program is difficult because correcting a negative impression is especially difficult.

### Role of Cooperatives in the Implementation of State and Regional Programs

Since cooperatives are essentially privately conducted and privately managed, the experts believe that conforming their behavior to state and regional programs is best accomplished through incentives. They cannot and should not be forced into compliance by governmental rule. They should instead be incentivized by reward.

The principal reward available from republican and local governments is through taxation exemptions and credits. If, for example, the Government wishes to reduce the amount of scrap and waste in production, the granting of tax credits from specified levels of achievement is the best way to accomplish this.

### External Economic Relations and Joint Ventures

The ability of private parties, including cooperatives, to sign joint ventures is legally about as recent as the existence of cooperatives themselves. The study team identified the strong desire of cooperatives to negotiate and establish joint ventures and thinks this strong desire will eventually express itself. But as of now, there are serious limitations on the ability of cooperatives to bring these into operating existence. The fact is that cooperatives are not well adapted to instituting joint ventures at the present time.

There have been a few large well-publicized joint ventures, but the fact is that most of them are with relatively small entities in the West. Such entities are hard to locate, and particularly so for a cooperative. Moreover, experience is needed in negotiating joint ventures and putting them into fruitful operation. There have been relatively few joint ventures in the consumer goods field where many of the cooperatives are situated. There is somewhat more possibility of technical exchange through joint ventures or of exchange of components or finished goods.

By far the largest inhibition on joint ventures at the present time is the lack of foreign exchange. In its absence, most of the foreign trade that takes place is essentially a barter operation. This does not offer as many opportunities for cooperatives as will be the case if foreign exchange is more available to them. Legally, foreign exchange is supposedly available at present, but it is understood there is no case where actual permission to access foreign exchange has been granted to a cooperative.

If the attempt is made to institute joint venture negotiations, there are several available parties that can help. Most banks, including cooperative banks, are setting up to provide this service. The Cooperative Association, when it is in operation, can also be of assistance.

### Questions for Further Discussion

1. Are cooperatives adequately integrated within the Soviet system? What specific steps should be taken to integrate them further?
2. How can regulatory rules, as distinct from the exercising of direct controls, best be developed in the Soviet Union?
3. What are the merits and demerits of a dependency relationship of a cooperative with a state enterprise?
4. Does the cooperative need more protection in law spelled out? At what governmental level (national, republic, local)?
5. What are the benefits/dangers to the cooperative of decentralization of control to the local soviet level? Is local discretion too broad or not broad enough?
6. What should be the essential elements of any public awareness program adopted by the Soviet Government to improve public opinion of cooperatives?
  - (a) Why do cooperatives have a bad public image?
  - (b) What should be done about it and by whom?
  - (c) What should the broad outlines of such a program be?
7. How realistic is it at this time for industrial cooperatives, especially medium-size ones, to pursue joint venture and foreign trade relationships?



## SECTION 2: INDUSTRIAL COOPERATIVES: INSIDE RELATIONS AND STRUCTURE

### Discussion

#### Membership and Ownership

The concept of ownership is almost unknown in the Soviet Union. Land may not be owned by an individual or by a cooperative; land ownership is reserved to the State.

Other production assets can be owned by cooperative membership. Buildings are rarely owned, but this is permitted and ownership of equipment is fairly common, particularly the less expensive types of equipment or used equipment which is frequently employed by cooperatives. Special supplementary methods of acquiring ownership of buildings, and to some extent equipment, are joint ventures in which one partner provides most of the money or bank loans.

The concept that those who work in a cooperative must all be members is not a necessary requirement for cooperative operation. In some jurisdictions, however, it is required that proportion of contract labor to members is limited. This concept does not have practical meaning and could inhibit morale and it should be discontinued.

#### "At Risk" Investment by Members or Owners

The cooperative movement may, without realizing it, be taking the first steps toward a distinction between membership and ownership. A concept that there can be non-working owners of a business is a concept largely foreign to the Soviet Union, but it may be developing. It is understood that there is a possibility of a forthcoming corporation law covering this kind of development. If so, this would represent a further important step in developing the concept of ownership.

"At risk" investment, called equity investment, does not exist in the Soviet Union except as internally generated from operations. This is because this kind of investment is linked to the concept of ownership. This is almost inevitably so since the existence of wealth available for investment is not equally available from all members. Therefore if roubles are to be donated and put at risk, this has to be done differentially, either by other institutions willing to take such risks in anticipation of potentially greater profits, or by selective individuals with the same motives. In return for making these investments of greater risk, either party is likely to demand many or all the perquisites and potential benefits that already exist for the more senior members of a cooperative. With these persons taking on a special preferred status even though they do not work in the cooperative as members, they inevitably fill a role very much like that of an absent owner.

#### Cooperative Management and the Cooperative Chairman

Most cooperatives are the creation of one individual who was one of the founders. Given the relative youth of the cooperative movement, that same person is still with the cooperative and has from the beginning been its Executive Director. In most instances studied, that person has an engineering background.

It was found that in actual practice, the authority of the Executive Director has relatively few restraints. There are only two institutions that have the legal ability to exercise internal supervision over the activities of the Executive Director: the membership body in toto or its Board of Directors. In both cases there are practical limitations in their ability to exercise this supervision. For industrial cooperatives of any size, the membership body acting as a whole in practice only takes measures confirming the decisions of the top managers. The Board of Directors, which is in more of a position to exercise active authority, is not realistically likely to do so except in extreme cases. In the instances reviewed, the Board of Directors in effect is the top administrative staff reporting to the Executive Director and appointed to the Board by him. Such a group is not likely to take stands adverse to the Executive Director unless the need to do so becomes extremely urgent.

This relative lack of restraint appears to be greater for an Executive Director of a cooperative than would be the case for his opposite number in the West, the Chief Executive Officer of a publicly owned corporation.

Members of cooperatives do not presently view this as being a problem, least of all the Executive Directors. It could become a problem and will in some cooperatives as they grow and evolve. An entrepreneur who founds a small company is frequently not equally skilful at running it when it becomes a large enterprise; this is a reasonably common condition throughout the industrial world. There is a need to spell out in some form of corporate governance law the rights and duties of management as distinct from the rights of the membership.

#### Cooperative Income and its Distribution

Cooperatives are different from state-owned enterprises (SOEs) in that they own the profits that they generate and in that they generally have higher profit margins than SOEs. Both of these facts mean that the cooperatives usually generate proportionately more cash than the SOEs and therefore have proportionately more to reinvest. Most of the Executive Directors of cooperatives and their senior staffs who were interviewed showed a strong preference for reserving generated cash for future reinvestment. However, there is frequently pressure from the cooperative members to commit a specified portion of cash generated to distribution to members, i.e., that there be a committed "dividend." Usually the cooperative management compromises by making a dividend commitment that is "loose"--it can be and is overridden if desirable or necessary investment needs arise.

#### Labor Productivity and Pay

There is some controversy about whether production cooperatives have greater productivity than state owned enterprises do. There is some conflicting evidence, but the experts believe the balance of the evidence says that they are more productive by a considerable margin. Despite the higher material costs imposed on some cooperatives, the end result is still typically one of high profits for the cooperative. The experts do not think that this is just a function of high mark-ups to the state owned distribution agency, although that is one factor, but that the majority of the difference has to be made up in higher labor productivity and perhaps in lower overhead.

Cooperative workers are paid on piece rate which tends to produce higher productivity. But the best indication of higher productivity is that production cooperatives pay basic wages that are at least 50% higher than in state owned enterprises. In most cases this is further supplemented by liberal bonuses that again can be somewhere between 50% and 100% of base pay. About the only factor working against higher productivity in the cooperative is a lower investment base per worker, but this is changing rapidly as reinvestment takes place. Despite higher wages and bonuses, production

cooperatives make profits in most cases at a high rate and the study team was sure it is at a higher level of profit than it would be for a state owned enterprise if profit could be computed for them. If correct, this more or less establishes that cooperatives have to have greater productivity. It is their estimate that a cooperative will produce 30% more profit at something like 30% more efficiency than would be the case with a comparable state owned enterprise.

Currently, cooperatives have been passing on a large part but not all of their greater productivity in the form of increased wages. This is supposedly economically desirable and at some point efforts should be made to pass some of this improvement on to the consumer in the form of lower prices.

### Cooperative Hired Labor

From the beginning of the cooperative movement, it was recognized that not all persons working in a cooperative were necessarily qualified to be members. As a result of this fact, the distinction between members and non-members, or hired labor, arose. In order that hired labor not be taken advantage of, in some cooperatives rules were applied as to the percentage of hired labor that would be permitted in the total work force. Furthermore, in some cases these percentages have been changed from time to time, usually being successively tightened.

The experts found that with the growth of the size of industrial cooperatives, these restrictions had now no important practical effect. The main effect of the hired labor percentage quota would be to make hired labor feel disadvantaged compared to members. It is, therefore, recommended that restrictions on the percentage of hired labor be dropped.

### Cooperatives and Trade Unions

The trade unions, so important in other aspects of Soviet industrial life, have not played an important part in the development of industrial cooperatives. In theory, the membership is the ultimate governing body. It has its own representation in the form of a membership council and therefore, again in theory, does not need the essentially parallel representation of a union.

In the future this may change with a role emerging for the union. Industrial cooperatives are growing in size and will probably continue to grow. Some of the largest have 3,000 to 4,000 member-workers. Global experience suggests that for entities of this size union representation may be appropriate and may emerge if only because for that many workers more compact representation may be needed.

### The Cooperative Association

The Cooperative Congress, held June 30-July 1, 1989, was the first step in forming an overall cooperative association.

All associations have certain broad purposes: they provide their members with services and information, conduct public relations, take official positions reflecting the members' concerns on relevant subjects and advocate these positions to governmental bodies. They assemble backup statistics, conduct research and issue reports and periodicals. They are a meeting forum for the members and sometimes they provide member training.

Along with this, an association specifically created for cooperatives would have certain specific duties. It would study the need for legislation, especially in the field of taxation, and represent members' collective views to government. It would provide studies and help in areas where special services are needed, for example, contract terms, loan instruments, relationships with state owned enterprises, etc. It would conduct information campaigns; especially needed is a public awareness campaign.

But above all, the central theme of the Association is that it is a means of providing political contact between the members and the various branches of government. An effective Executive Director is the key and he especially must be effective politically.

It is best to have one cooperative association rather than splintering into many. Since many geographically-specific and industry-specific cooperative associations already exist, the new association must of necessity be a federation that coordinates the other smaller, already-existing associations.

Broadly, the sequence of establishing the Association is first to give it the organizational backing of a set of by-laws and other incorporation necessities. An organization committee must decide on the missions that the Association should undertake and out of this would be formed a budget from which in turn would evolve a proposed dues structure. At an early stage, an Executive Director must be sought out and his tentative acceptance to appointment settled upon in advance.

#### Questions for Further Discussion

- (1) The right to share in cooperative profits is presently confined to members. Will this evolve into a concept of ownership as distinct from membership? Should it?
- (2) As the cooperative movement matures, what organization problems seem likely to arise within cooperatives?
- (3) In the interests of the business but also of the membership, does the Executive Director have too much or too little authority?
- (4) Will the present earmarking of profits as "for distribution" as distinct from "for reinvestment" evolve into a "dividend" with the greater commitment that implies? Should it?
- (5) Is cooperative labor more productive than in state enterprises? Why is this the case?
- (6) Is the concept of greater pay for greater productivity economically good or bad?
- (7) What should be the role of the trade union in a membership organization?
- (8) What should be the principal objectives of a Cooperative Association and how should it carry them out?
- (9) Service cooperatives are very different from production cooperatives. Can a single association serve the needs of both?

## SECTION 3: ECONOMICS OF INDUSTRIAL COOPERATIVE ACTIVITIES

### Discussion

#### Material and technical provision of industrial cooperatives

In the 1980's, many of the centrally planned economies in the world have encountered a number of dislocation problems. In the Soviet Union, as in many other countries, a condition of general shortage of materials exists. Added to these difficulties is increasing inflation.

This general shortage condition makes operations difficult for all industrial enterprises but it is particularly difficult for cooperatives. They of course do not have and should not have subsidies. They operate outside the system of allocation, and regular channels of supply. Cooperatives, as one example, use a great deal of waste material and used equipment. In order to establish continued operations, substantial stockpiling occurs when this is possible. Barter is a regular way of life. To many cooperatives, continuation of a relationship whereby a state owned enterprise provides them with help is essential. That cooperatives can operate as successfully as they do is a tribute to Soviet ingenuity operating under difficulty.

Some, but not all of the industrial cooperatives are afflicted with a special discriminatory tax called the cost mark-up. In cases when this tax is applied, the regular "market" price of supplies is further marked up, generally from two to six times depending on the nature of the commodity and the attitude of the cooperative's governing body, usually, a local soviet. In theory, this is a tax applied to cooperatives to equalize mark-up applied to state owned enterprises when their product is transferred to state owned distribution channels. In practice, it is a discriminatory tax, which, however, most cooperatives have been able to offset by other operating efficiencies.

Nevertheless, this is an illustration of a major cooperative complaint: they do not operate on a "level playing field" in competing with state owned enterprises and in fact, they believe that the entire system is geared against them.

Experience elsewhere in the world under centrally planned economies shows that trying to free one segment of a controlled economy from controls is extremely difficult. It calls for careful planning and a program of disengagement that has been well thought through. Nevertheless, if cooperatives are to make their full contribution to the national economy, such a program of disengagement must be started. It would be best to begin this program in areas where shortages are less acute.

#### Sales channels for cooperatives output

In one sense, industrial cooperatives operate under a two-tiered pricing system. Like state-owned enterprises, they are required to fulfill production quotas. These quota quantities must be fulfilled and must be supplied to the state wholesale monopoly at mandated prices. Many of these quota fulfillments are taken on by cooperatives in behalf of state-owned enterprises by mutual agreement between them.

Once these quotas are fulfilled, any excess production may be sold to any customer at any price the cooperative wishes. These over-quota products may be sold wholesale or retail and to the state as customer or direct to users or private wholesalers to the extent the latter exist.

The study team found this system whereby a free market exists only as surplus to a state-controlled market an inhibiting mixture seriously limiting the ability of the free market to operate. The production quota system is fundamentally incompatible with a free market system and should be phased out as rapidly as possible.

Furthermore, it was found that the state-controlled wholesale distribution channel, with its high markups and monopolistic position is in itself an important deterrent to free market conditions. It should be a state objective to introduce competition into the wholesaling of production.

### Lease Procedure

As previously mentioned, private ownership of land is as yet unknown in the Soviet Union; ownership of industrial buildings is rare, but permitted; ownership of equipment particularly less expensive equipment, is fairly common. Ownership is the prevailing pattern for current assets (life of less than one year).

But the most customary form of acquiring fixed assets is by lease. Term leases for buildings and for major pieces of equipment do exist, but by far the more customary arrangement is for the lease period to be unspecified or for the lease termination penalty to be non-specific and therefore not a bar to cancellation. Interestingly, the concept of lack of lease assurance is not troublesome to many of the production cooperatives but those conducting this study believe it will become an issue as the need for reinvestment grows and as the Executive Director (who is also an investor) needs reasonable assurance of earning an adequate return on investment. They also believe that the bodies charged with governance of cooperatives, usually the local municipal council, should retroactively adjust leases so that cooperatives have some term of assurance of continuity and that future contracts should similarly contain such assurance. At least three to five years for equipment is suggested and longer where major building investment is involved.

### Financial and Credit Systems for Cooperatives

The rapid growth being experienced by industrial cooperatives means that large amounts of cash will be required to support this growth.

The fact that there are not widespread cash shortages or as severe a cash flow problem as expected is due to the favorable cash flow profile so far developed by the cooperatives. Most industrial cooperatives have been highly successful with a high profit rate that generates a significant part of the needed cash. The Soviet economy is a cash society and has a pattern of very rapid payment of accounts. As long as this continues, this will also help fund cash requirements for growth. On the other side is the necessity for heavy inventory accumulation given the present uncertainties and shortages affecting operation.

Any industrial entity has three basic sources of needed capital:

- (1) cash generated by the operation of the entity.
- (2) cash borrowed from others, usually loaning institutions, with fixed obligation terms of payment and cost agreed upon in advance
- (3) cash contributed at risk and therefore usually without committed obligation by individuals or institutions, usually the owners (or members) of the entity.

There are two basic uses to which capital can be put: working capital or fixed capital. Fixed capital is understood to be the land, buildings, equipment, tools, dies and fixtures providing they are owned by the entity or its members and providing they have a useful life of more than one year. The rollover of long-term financing of prior long-term obligations would be included. Working capital requirements are everything else, usually principally including inventory, accounts receivable, and the discharge of shorter-term obligations such as payroll and accounts payable. Ideally, the type of financing selected is influenced, among other things, by the use for which it is intended.

Borrowed capital can be either in the form of "loans" or "bonds." Several types of each exist in various societies. In the Soviet Union state-owned banks making loans have existed of long standing. More recently, cooperative banks have been created. As of July, 1989 there were 43 of these and one of them is the basis of a case study presented to this symposium. In theory, any bank of either kind can loan to either an SOE or a cooperative. In actual practice, the state-owned banks have sometimes given preference to their traditional customers, the SOEs, on occasions when credit is short, sometimes to the disadvantage of the cooperatives. Cooperative banks were created so that they could especially finance cooperatives. This has helped the financing of cooperatives.

Bonds, which are usually a more general obligation and one that is more readily transferrable, do not exist widely in the Soviet Union. They do, however, exist in other Eastern Bloc and socialist countries and this form of financing may come to exist more widely in the Soviet Union.

### Pricing

Most industrial cooperatives reviewed, despite their complete freedom to sell at retail direct, have as their principal customer a state wholesale distribution agency. For both the state owned manufacturing enterprises and for the cooperatives, transfer prices to the state agency are at high mark-ups. Although cooperatives have the popular reputation of charging consumers unreasonably high prices compared to state produced goods, in almost all instances the study team encountered, the transfer price to wholesale by industrial cooperatives was equal to or on occasion lower than the transfer price from state-owned enterprises. The penalties of lack of material availability and high material cost are more than made up with lower labor costs and perhaps lower overhead. As a result, industrial cooperatives are typically highly profitable. Cooperatives do not have the advantage of subsidies and they should not.

The cooperatives' primary objective is and has to be generating funds for reinvestment and further growth. Nevertheless, it was also evident that cooperatives have a strong sense of social responsibility, believed to be at least equal to that of state owned enterprises.

The profit pattern of cooperatives and the accompanying pattern of strong cash flow, in most cases supplemented by available bank credit is entirely appropriate to a growing economic sector such as the cooperatives.

The main problem in this pattern is one of price control. Experience elsewhere shows that disentangling one economic sector from an overall pattern of state control is extremely difficult to accomplish and takes a long time. It is doubly difficult to accomplish this wisely, subject as most of today's economies are to inflation.

There is one missing element in the description of this profit pattern. This is the element of competition and consequent benefit of the availability of goods at relatively low prices for the ultimate consumer. At the present time the cooperative movement is still too small a factor in the overall economy for competition to have been effectively introduced by it. As the movement grows, this will in time occur.

A program phasing out price controls in favor of a market-determined system of pricing and superceding the monopolistic state-controlled wholesale distribution channel with a more competitive system is in line with the recent U.S.-Soviet Malta conference.

### Taxation

The number one issue in the minds of almost all senior managers of industrial cooperatives is taxation. This is because of a fundamental change in tax schedules proposed last spring and scheduled to be effective July 1, 1989. The problem is twofold. First, taxes are to be increased sharply after less than two years of cooperatives existing legally. Second, there is considerable uncertainty as to what specific taxes will be and behind this a feeling that the government is uncertain of its attitude toward cooperatives and is sending the movement mixed signals on its intentions. It is clear that cooperatives are and would be taxed disproportionately when compared with state owned enterprises.

Some cooperatives pay a tax in the form of a mark-up on materials. As individuals members of cooperatives pay individual income taxes; since their earnings tend to be higher, they pay more taxes. But the principal tax in question is the tax paid by the cooperative itself. This tax is paid on "value added," i.e., revenues less material costs. Before July 1, the tax rate was very moderate, 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. Now the new tax after July 1, 1989 is increased to a range of 5% to 60% with the general expectation that at least in some of the more industrialized republics, taxes for industrial cooperatives will be around 30%. State owned enterprises also pay a value added tax of 17% to 25%, but if present intentions stand, they will paying less taxes than a comparable cooperative which the study team believes to be already the case in most instances anyway.

The sequence of determining taxes is as follows: the Supreme Soviet has laid down very general guidelines. Each republic will then select the basic tax rate for each specific enterprise. The local soviets may grant allowances on quite a number of grounds that can be significant in amount.

It is the study teams opinion that a 30% tax rate borders on being confiscatory and rates above that are clearly so. It also believes that the basic tax rates should be 20% but not over 25% and that local soviets should be permitted to grant allowances of not over 10 percentage points based on factors as laid down in the new tax law. Furthermore, there should also be an investment credit with maximum limitations to encourage the cooperatives' basic financial need: reinvestment. The mark-up tax is discriminatory and should be phased out. There should be government encouragement for passing tax savings through to consumer prices.

Construction of a proper tax program is a highly technical matter that will involve substantial additional detailed planning.

### Particular Regional Conditions

The Soviet Union is a huge and very diverse country. Economic conditions that prevail in one republic are utterly different from conditions in other republics.

As part of the program to ease the rigidities of the previously centrally planned economy, the Soviet Union is in the midst of a program to decentralize almost all detailed implementation policies and authority to at least the republican level.



When these two facts are put together, it follows that the governmental rules and procedures for one republic can be markedly different from those of another republic in a different geographic area. It is both inevitable and appropriate that these particular regional conditions should be recognized. But the study team draws a careful distinction between the recognition of these differences, which is good, and the creation of excessive local latitude, which the study team feels is in danger of being carried to excess.

### Questions for Further Discussion

- (1) What are the ways in which cooperatives have been able to overcome national supply shortages?
- (2) What kind of government program can be instituted to improve operating conditions for cooperatives?
- (3) What is the least disruptive program that could be designed to phase out the production quota system at least as it applies to industrial cooperatives?
- (4) What legal assurances are needed establishing contractual obligations in leases?
- (5) What kinds of financing vehicles are readily available to cooperatives? What kinds are less readily available? Are additional kinds of financing vehicles needed?
- (6) In your opinion, do cooperatives have adequate available credit?
- (7) What financial problems will arise as cooperatives have increasing need for reinvestment to permit continued growth?
- (8) What additional freedom should cooperatives be given in pricing their products?
- (9) How can the cooperative be given freedom to respond to the market in an economy where state controls will not be eliminated all at once or soon?
- (10) Does the new July 1, 1989, tax law tax the cooperatives fairly? (a) in comparison to state-owned enterprises? (b) in terms of their ability to pay and their future needs?
- (11) What problems arise from lack of uniformity of proposed tax rates?