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האוניברסיטה העברית בירושלים

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**Agricultural Cooperative Development in Kazakhstan
and Ukraine**

By

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Agricultural Cooperative Development in Kazakhstan and Ukraine

David Sedik¹ and Zvi Lerman²

This article reviews the evidence on agricultural service cooperatives in two countries of the Commonwealth of Independent States (CIS)—Ukraine and Kazakhstan—and considers the reasons for their lack of development compared to the countries of North America and Western Europe. Only one farm in 246 in Ukraine and one in 31 in Hungary are members of a service cooperative, while in the US and France each farmer is a member of a service cooperative and in Italy every other farmer is a member (**Table 1**). There are also far more farms per cooperative in Kazakhstan, Ukraine and Hungary, than in the countries of Western Europe and the US. Whereas there is only one cooperative for every 6,000 farms in Ukraine and Kazakhstan, and for every 10,000 farms in Hungary, in France there exists one service cooperative for every 178 farms. This statistic also indicates that the development of service cooperatives in Eastern Europe and the CIS is far behind that in the US and Western Europe.

Table 1. The development of agricultural service cooperatives in selected countries

Country	Year	Number of agricultural service cooperatives	Number of cooperative members	Number of farms	Ratio:	Ratio:
					Farms per member	Farms per cooperative
Ukraine	2010	801	21,521	5,300,000	246	6,617
Kazakhstan	2010	300	N.A.	1,850,000*	N.A.	6,167
US	2010	2,310	2,200,000	2,200,000	1	952
France	2010	2,900	500,000	516,100	1	178
Hungary	2007	58	20,177	626,300	31	10,798
Italy	2008	5,800	900,000	1,679,400	2	290

Sources: US: USDA, 2012, USDA-NAS, 2013; Ukraine: Korinets, 2013: 36, 38, State Statistics Service of Ukraine, 2011: 10, State Statistics Service of Ukraine, 2012: 51; France: Eurostat, 2013, Filippi, 2012: 14; Hungary: Szabo, 2012: 23; Italy: Bono, 2012: 19; Kazakhstan: number of service cooperatives from Conception (2012), number of farms see next note.

*The sum of peasant farms (170,000) plus an estimate of the number of household plots (1,680,000, assuming that each rural household has a household plot). Data for peasant farms from *Agriculture in Kazakhstan 2007-2011* (Statistical Agency, Astana, 2012); data for rural households from *2009 Population Census of Kazakhstan: Households*, vol. 1, p. 4 (Statistical Agency, Astana, 2011). Similar numbers emerge from the 2006-2007 Agricultural Census (Astana, 2008).

A number of reasons are often cited for the dearth of self-help organizations in ex-socialist countries (Akimbekova, 2010; Korinets, 2013; Tomich, 2013):

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- (1) the agricultural policy environment may not encourage, and may even discourage, the formation of self-help groups such as service cooperatives;
- (2) joining a cooperative may increase the tax burden of farmers;
- (3) small farmers have limited startup capital, while working service cooperatives usually require substantial investment in order to justify themselves financially;
- (4) there are a limited number of leaders capable of professionally managing cooperatives in the countryside;
- (5) there is a noticeable and understandable distrust in cooperation among the rural population (which is predominantly old) because of their previous experience with the socialist version of cooperation;
- (6) rural people have limited understanding of principles and direct benefits of cooperation, which is necessary for counteracting the attitude of distrust.

There are potentially good economic reasons for farmers to cooperate in Kazakhstan and Ukraine. However, the *need* to cooperate is not enough. Support for the cooperative idea is low in the CIS countries based on past experience with the Soviet cooperative model, and due to the lack of information on and experience with alternatives.³ Overcoming the legacy of the past requires a “reimagining” of the cooperative model on the part of farmers and policymakers. Farmers need to experience the liberal-democratic model of cooperation, while policymakers need to recognize that the role of the state in organizing service cooperatives is minimal. Public policy should provide a supportive enabling environment for service cooperatives while simultaneously ensuring that both the government and farmers are aware of the change from “cooperation” imposed from above to the Western liberal model of self-help style, grass-roots cooperation. This has been a difficult task for CIS governments.

To understand how governments in Ukraine and Kazakhstan have dealt with this task we consider two aspects of the enabling environment. First, we consider policies—what do state policies illustrate about the attitude of the government toward cooperatives in Ukraine and Kazakhstan? Second, we analyze legislation to gauge the extent of state support for agricultural service cooperatives and how it could be improved.

³ Academic researchers have investigated the issue of distrust in cooperation in post-socialist economies more formally. Gijssels and Bussels (2012) investigated two potential reasons for the lack of cooperation in the ex-socialist countries of Europe, finding high correlations between indicators of “social capital” and member intensity of agricultural cooperatives (percentage of farmers of a country that are cooperative members), but no discernible correlations between indicators of “general deep-rooted cultural values” and member intensity. “Social capital” is defined as “the trinity of ‘networks, norms of reciprocity and trust’” (Gijssels and Bussels, 2012). Indicators of “general deep-rooted cultural values” were based on research by Hofstede, Hofstede and Minkov (2010). Lissowska (2013) came to similar conclusions in her analysis of social attitudes towards cooperation in European countries (based on the European Social Survey), where she found that the preference for cooperation in transition countries (Central and Eastern Europe, Russia and Ukraine) is close to that of the other (Western) European countries. However, transition countries differ in that people have less faith in the cooperative model based on their past experience with the socialist version of cooperation, which usurped and distorted the liberal democratic model of cooperation that pervaded Europe (including Russia and Ukraine) before socialism.

The need for agricultural service cooperatives in Kazakhstan and Ukraine

Agriculture in the CIS countries is based primarily on smallholders – peasant farms and household plots. The smallholder farm sector produced 70 percent of Gross Agricultural Output (GAO) in Kazakhstan and 55 percent in Ukraine in 2011 (Statistical Agency of Kazakhstan, 2012; State Statistical Service of Ukraine, 2012). Small farms everywhere in the world face constraints in their access to market services, and the CIS countries are not an exception in this regard. The main difficulties faced by smallholders include:

- difficulties with access to sales channels for market products,
- difficulties with access to supply channels for farm inputs,
- difficulties with purchase of farm machinery and transportation equipment,
- difficulties with access to information and advisory services, which are essential for raising productivity and efficiency,
- limited access to credit resources, which are required to finance short-term working capital and long-term investment needs.

These difficulties combine to create what is sometimes referred to as “the curse of smallness”, a trap that prevents smallholders from fully exploiting their inherent productivity advantages due to barriers in access to markets (Abele and Frohberg, 2003).

In developed market economies private intermediaries often compete to buy and sell agricultural commodities from farmers, or farmers themselves market their own production. In the CIS countries such private rural intermediaries often act as monopsonistic buyers in the region they operate. In such cases in market economies farmers organize self-help bodies – so-called service cooperatives, whose function is to correct market failure by allowing alternative access to markets without relying on private service intermediaries. Such cooperatives can cover the whole field-to-market value chain, including joint purchase of farm inputs, attention to water distribution and irrigation (through Water User Associations), organization of machinery pools for field work, establishment of sorting and packing facilities, transport of farm products to markets, processing, etc. They can also provide agricultural extension and market information services, as well as veterinary and artificial insemination services, all of which are essential for productivity improvement in both crop and livestock production. What service cooperatives do not do is engage in primary agricultural production as a collective of farmers.

In dealing with a service cooperative, the market effectively deals with a relatively large entity that combines many smallholders into a single negotiating position. Access difficulties imposed by smallness are thus automatically lifted. Service cooperatives overcome the “curse of smallness” by conducting market transactions for a large number of small farmers simultaneously.

Ukraine and Kazakhstan policies on agricultural service cooperatives

Ukraine

The government of Ukraine has consistently declared support for agricultural service cooperatives over the past ten years, while implementation of this support has been far less consistent. More importantly, government programs, when they did provide support, focused on subsidies, rather than on making information for farmers widely available on the financial benefits of cooperatives and how to form them. Grass-roots education programs and publications on the benefits of cooperatives, including legal assistance for forming new cooperatives, has not been a major part of government policy in Ukraine. The main support of the government to agriculture has been the special agricultural VAT tax regime, which strongly skews the beneficiaries by distributing the largest share of subsidies to a relatively small number of large producers rather than tens of thousands of smallholders.

The Presidential Decree *On Means for Development of the Cooperative Movement and Strengthening of its Role in the Market Reform of the Ukrainian Economy* (President of Ukraine, 2000) foresaw the organization of a credit line, local budget resources for the development of service cooperatives and a fund for the support of service cooperatives in procuring bank loans, including loan guarantees. As of 2009 no funding for cooperatives was made available from the central government (Korinets, 2013:56). *The Program for the Development of Agricultural Service Cooperatives for 2003-2004* (Ministry of Agrarian Policy, 2002) also promised support for cooperatives, though the means for this support would come from “domestic and foreign investors, share contributions of cooperative members and funds from local budgets. Ukrainian Law *On the Main Pillars of State Agrarian Policy to 2015* (Parliament of Ukraine, 2005) noted that one of the main priorities of the state agrarian policy was “state support for the development of competitive agricultural production on the basis of cooperation and integration.” The *State Special Program for the Development of the Ukrainian Village to 2015* (Ministry of Agrarian Policy and Food, 2007) also envisioned state support for agricultural service cooperatives with no apparent budget resources made available (Korinets, 2013:57).

The first substantial funds made available from the central government for the development of agricultural service cooperatives were in accordance with the Cabinet of Ministers Decree no. 557 (3 June 2009), *The State Special Economic Program for the Support of the Development of Agricultural Service Cooperatives to 2015* (Cabinet of Ministers of Ukraine, 2009). This decree planned for the creation of an additional 2,500 cooperatives through support for enabling legislation, funding infrastructure and removing obstacles for cooperative development. In fact, the program made funds available only for purchase of agricultural machinery for cooperatives (Korinets, 2013: 56).

In 2011 the Ukrainian government again declared its support for agricultural cooperatives. In November 2011 President Yanukovich noted that “along with efforts to strengthen private farmers and large scale private producers, it is also necessary to do everything possible to develop the new cooperative movement in the countryside. They should become an important

foundation of the structural reform of agriculture” (Korinets, 2013: 57). Support was continued into 2012 with the new version of the law *On Agricultural Cooperation* (Parliament of Ukraine, 1997), signed into law by the President on 19 January 2013. According to this legislation, 5 million UAH was to be made available for purchase of agricultural machinery by cooperatives. Finally, in February 2013 Minister of Agrarian Policy Prisiazhniuk noted that “we are planning the development . . . of rural areas and the formation of a rural middle class. And the main mechanism we are proposing is agricultural cooperation, which will help increase the competitiveness of small producers and form the basis for the renaissance of the Ukrainian village” (RBK-Ukraine, 2013).

Kazakhstan

The latest official policy on cooperatives in Kazakhstan is concisely summarized in the *Kazakhstan-2050* strategy⁴ presented by the President on the eve of Independence Day in December 2012:

It is important to raise the overall level of business culture and to stimulate entrepreneurship. . . . To this end we must encourage the attempts of small and medium business to establish associations and cooperatives and create an appropriate system of support and incentives for the entrepreneurs.

A more detailed exposition of government policies for agricultural service cooperatives can be found in *Conception* (2012). This basic document outlines three main policy directions:

- improvement of legislative base;
- financial support (loans at subsidized interest rates, government subsidies for inputs and investments, tax breaks);
- provision of information and training.

Attempts to improve the legislative base continue, mainly through the efforts of the agricultural lobby,⁵ but very little seems to be happening with provision of information about cooperatives and training for producers and potential managers. As in Ukraine, the main policy focus is on financial support, including credit and subsidies. Two models of government support are observed in Kazakhstan, both relying on state-controlled companies:

- “Agricultural Credit Corporation”, established in 2001, is an arm of the Ministry of Agriculture that grants 5-7 year loans at 5% per annum as seed money for the creation of rural service cooperatives (not including Water User Associations);
- “Social-Entrepreneurial Corporations” (*Natsional’naya kompaniya “Sotsial’no-predprinimatel’skaya korporatsiya”*) forming a regional network of state–private partnerships entrusted – among other activities – with the establishment of service–

⁴ <http://adilet.zan.kz/rus/archive/docs/K1200002050/14.12.2012>

⁵ See, e.g., <http://www.all-docs.ru/index.php?page=7&vi1=134686.000>

procurement centers (*servisno-zagotovitel'nye tsenry* – SZTs) that provide agricultural services to rural service cooperatives and agricultural producers; participation of service cooperatives in equity capital is a necessary condition for the creation of service–procurement centers.

Up to April 2009, the Agricultural Credit Corporation had distributed 8 billion tenge (US\$50-65 million depending on exchange rates) in subsidized agricultural loans (Conception, 2012; Akimbekov, 2010). It is argued that the availability of low interest-rate credits and other subsidies intended specifically for service cooperatives encourages the creation of “false cooperatives”, i.e., cooperatives that are established only for the purpose of gaining access to subsidized credits and inputs, without any regard for true cooperative principles. This trend may be responsible for the large discrepancies in cooperative statistics from different sources and for the large gaps between the number of registered and active cooperatives. As to service–procurement centers, in reality they duplicate the basic functions of service cooperatives without any attempt to adhere to cooperative principles. They appear to be a carry-over from the Soviet model of enlargement that characterized the agro-industrial complex, and their goal is apparently profit maximization, as is evident from the high prices that they charge for the services to cooperatives and farmers (Conception, 2012).

Enabling environment: Classification and characteristics of cooperatives

The International Cooperative Alliance (ICA) defines a cooperative as an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically-controlled enterprise (ICA, 2013). The persons who voluntarily unite to form a cooperative are usually referred to as members or member-owners, and one of the key attributes of membership is active participation in the activity of the cooperative (whether economic, business, or social). A cooperative is a legal entity and in a certain sense it is an analogue of a shareholder corporation. There are, however, some fundamental differences between a cooperative and a corporation, as listed in **Table 2**.

Table 2. Comparative attributes of a cooperative and a shareholder corporation

Attribute	Cooperative	Corporation
Owners	Members	Shareholders–investors
Owners' objective	Use of services provided by the cooperative	Earning income
Organization's objective	Maximize members' benefits from working with the cooperative	Maximize corporate profits
Voting rights	One member–one vote, regardless of share contribution	Number of votes proportional to number of shares (i.e., share contribution)
Income distribution rules	Income distributed to members in proportion to their participation in the activity of the cooperative	Income distributed to shareholders in proportion to the number of shares held

Perhaps the main difference concerns the organization's objective: while business corporations aim to maximize their profit, cooperatives aim to maximize the benefits that

members derive from their participation in cooperative activities, including lower prices paid for inputs and services and higher prices received for products (Cobia, 1989).

The Western cooperative paradigm distinguishes between *production cooperatives*, *service cooperatives*, and *consumer cooperatives* based on their functional characteristics.

Production cooperatives are cooperatives in which members are jointly engaged in the production process – irrespective of whether this is production of manufactured goods, agricultural commodities, or services. Production cooperatives are based on member labor and they sell their output to outsiders; yet the main function of production cooperatives is to improve the wellbeing of their members by providing jobs and working conditions that are superior to what would otherwise be available in the market. In agriculture it is often argued that, by allowing members to pool their fragmented smallholdings into large farms, production cooperatives exploit economies of scale and achieve higher efficiency. Yet many researchers have in fact shown that agricultural production cooperatives are substantially less efficient than individual and family farms. As a result, production cooperatives in the world are a tiny minority among organizations that produce manufactured goods, agricultural products, or services. According to ICA data, production cooperatives account for less than 5% of all cooperatives in the world

Service cooperatives, on the other hand, are the largest and most typical category of cooperatives: these are cooperatives that provide services to their members-producers, who continue to carry out all production activities independently on their own. In contrast to the minor role of production cooperatives in market economies, service cooperatives in many countries account for a large share of transactions in the relevant economic sector. For instance, agricultural marketing, processing, and supply cooperatives are major players in markets for farm products and farm inputs in North America, Western Europe, Japan, and South-East Asia. In the U.S., agricultural cooperatives handle about 30% of farmers' total farm marketing volume and 28% of farmers' total supply purchases (Mather et al., 2004). In the European Union, the share of agricultural cooperatives is even larger: in countries such as the Netherlands, Denmark, Ireland, and Sweden 70%-80% of farm products are marketed through cooperatives and cooperatives account for 50%-70% of all farm input purchases (Van Bakkum and Van Dijk, 1997).

Service cooperatives may actually employ some of their members as workers, but most employees (and even most managers) are hired outsiders. Service cooperatives use members' share contributions to capital and borrowed funds to finance purchase of goods and services from various market sources and then resell these services to members at advantageous prices.

Consumer cooperatives in Western nomenclature are trading firms that sell consumer goods primarily to their members at advantageous prices. They are basically a variety of supply cooperatives (outside agriculture), but they are treated as a separate class because of their numerical importance in the world. The largest segment of consumer cooperatives is cooperative food stores and supermarkets ("grocery stores"), but cooperative stores that sell

clothes, housewares, appliances, and even cars to their members – at advantageous prices – also fall in the category of consumer cooperatives. In the West, consumer cooperatives, unlike other service cooperatives, are most likely to deal with non-members (“third parties”) on a regular basis: this is their strategy of achieving growth comparable with other firms in the highly competitive consumer services sector. Consumer cooperatives typically charge a higher price on their transactions with non-members.

Ukraine and Kazakhstan legislation on agricultural service cooperatives

The USSR law on cooperation

The first mention of cooperatives in Ukrainian and Kazakh legislation actually predates independent Ukraine and Kazakhstan, occurring in the USSR law “On Cooperation in the USSR” (1988). This law set the precedent for subsequent legislation in that it considers two main types of cooperatives—consumer (*potrebitel'skie*) and production (*proizvodstvennye*) cooperatives. However, the conceptual distinction between the two types (article 3.2) is not mutually exclusive. Production cooperatives are defined to “produce goods, products, works and also render paid services....They are created and operate for production, procurement, processing and marketing of agricultural production....” Consumer cooperatives serve the demand of their members and other citizens in trade and service industries, as well as their members for housing, dachas and garden plots, garages and parking places for automobiles, social-cultural and other services. In addition to these functions, consumer cooperatives may also develop various production activities, which are not necessarily limited to processing and may include “subsidiary” agricultural enterprises.

The 1988 law is usually credited with being the first step toward private enterprise and market economy in the USSR under the guise of “cooperatives”, which were defined as new organizational forms free from strict state control – but without adherence to Western cooperative principles. Yet this 1988 law (articles 45-46) also perpetuates the traditional Soviet system of state-controlled “consumer cooperation” (*sistema potrebitel'skoi kooperatsii*), which operated in rural areas since the early 1920s and was primarily designed to provide farm services (product marketing, input supply) to household plots and consumer services (through trading outlets) to the rural population in general. Since the Soviet “consumer cooperation system” was in effect a system of (state-run) service facilities for small producers and rural people, a semantic link was forged in Russian between “consumer cooperative” and “service cooperative”. The term “consumer cooperative” is accordingly still used in the legislation of some CIS countries (in particular, Kazakhstan) in the sense of “service cooperative”, while other countries (e.g., Ukraine, Kyrgyzstan) have adopted the Western term “service cooperative”.

Ukraine cooperative law

The basic law on agricultural cooperatives under independent Ukraine (On Agricultural Cooperation, 1997) represented an immense improvement over the 1988 USSR law. This law seems to be drafted in accordance with the principles of the International Cooperative Alliance. The concept of “consumer cooperative” was replaced with the Western concept of

“service cooperative” (*obsluzhivaiushchii kooperativ* in Russian, *obslugovuiuchii kooperativ* in Ukrainian), and the conceptual distinction between production and service cooperatives is clear. An agricultural production cooperative is defined in article 1 of the law as “an agricultural cooperative formed by the union of physical persons who are agricultural producers for joint production or other activities according to the principle of obligatory labor participation with the goal of making a profit.” An agricultural service cooperative is “an agricultural cooperative formed through the union of physical and/or legal persons who are agricultural producers for the organization of services aimed at reducing costs and/or increasing incomes of the members of the cooperative in their agricultural activities.” Agricultural service cooperatives service their members “without the goal of making a profit and are non-profit organizations (art. 9).”

With the additional law “On cooperation” (On cooperation, 2004) the basic legal framework in Ukraine for agricultural service cooperatives was defined. The 1997 and 2004 laws have been amended many times over the past decade and a half with the aim of improving the enabling environment for cooperatives in Ukraine. The last amendment to the law “On agricultural service cooperation” was passed by the Parliament on 20 November 2012 and was endorsed by the President of Ukraine on 19 January 2013.

Kazakhstan cooperative law

The basic definitions of cooperatives as a corporate form of organization appear in the Civil Code, which was originally adopted in 1994 and then repeatedly amended. Unlike Ukraine, however, Kazakhstan has never adopted the term “service cooperative” in its legislation and continues to use the traditional Soviet terms for the dichotomy of cooperatives: “production cooperative” (*proizvodstvennyi kooperativ*) and “consumer cooperative” (*potrebitel'skii kooperativ*). Despite the retention of the traditional Soviet term “consumer cooperative”, this concept in Kazakhstan has been detached from the sweeping concept of “rural consumer cooperation system” (the Soviet-model *potrebsoyuz*), which is intended (on paper) to serve the entire rural population at the level of household plots, providing collection/marketing of produce and extending consumer goods sales through a network of stores in villages.

A detailed definition of production cooperative was included already in the 1994 version of the Civil Code (art. 96-101), where it is basically consistent with the Western concept of production cooperative. A new definition of consumer cooperative was added in 1998 (art. 108), and it became clear that the term “consumer cooperative” in Kazakhstan is in effect identical with the Western term “service cooperative”. Production cooperatives are defined as “commercial” (i.e., “for profit”) organizations employing members’ labor. Service (“consumer”) cooperatives are defined as “non-commercial” (i.e., “not for profit”) organizations that may employ hired labor. Non-commercial organizations may not distribute their surplus (“profit”) to members: all profits must be retained as cooperative equity (*Law of Non-commercial Organizations*, January 2001, art. 2; this principle is explicitly specialized to service cooperatives in art. 14(4)).

Five cooperative-related laws were passed between 1995 and 2003, elaborating on the basic definitions in the Civil Code:

- Law of Production Cooperative (1995)
- Law of Rural Consumer Cooperation (1999)
- Law of Agricultural Partnerships and Their Associations (2000)
- Law of Consumer Cooperatives (2001)
- Law of Rural Consumer Cooperatives of Water Users (“Water User Associations”, 2003).

The laws clearly define the main types of cooperatives – production and service (or “consumer”) cooperatives and there is generally no ambiguity as to cooperative types in Kazakh legislation. The only quirk is that the Russian term “consumer cooperative” (*potrebitel'skii kooperativ*) should be consistently rendered as “service cooperative” in English. Comparative analysis of the five laws shows that they mostly repeat the same cooperative principles and attributes. All cooperatives are voluntary associations of users who have a common goal and engage in common activities, the cooperative is created by a general assembly of its founding members, the assets of a cooperative represent the sum total of members’ contributions (“shares”) and cumulative retained profits, all cooperatives primarily serve their members but may also engage in transactions with non-members. The Law of Agricultural Partnerships holds a somewhat special place, as it explicitly stipulates that an agricultural partnership sells its services to members *at cost*, so that no profit is created. The services provided by an agricultural partnership to its members include marketing, storage, processing of farm products, supply of farm inputs, etc. An agricultural partnership is thus essentially a classical service cooperative.

Taxation of cooperatives

A cooperative is a legal body that deals with other legal bodies (agricultural enterprises and peasant farms) and also with smallholders who are not registered for tax purposes (e.g., household plots). The cooperative as a legal body is subject to taxation, which includes both profit tax and VAT. Smallholders, on the other hand, are typically exempt from these taxes or avoid them in various semi-legal ways. As a result of the taxes that cooperatives pay, a smallholder dealing through a cooperative is likely to net less from marketing transactions (or pay more for purchasing transactions) than the amounts he would have received (or paid) by dealing directly with buyers and suppliers. These tax distortions place cooperative members at a disadvantage compared to those who operate independently.

Conceptual issues of cooperative taxation

Profit tax and cooperatives. Although in principle cooperatives are non-profit organizations, their financial reports may show an accounting profit at the level of revenues and expenses (called “surplus” in Western cooperative accounting). This accounting profit is created

because the cooperative may have initially underpaid its members for products delivered (expenses too low) or overcharged them for inputs supplied (revenues too high). In effect the accounting profit is the result of internal pricing decisions within the cooperative, and not profit in the usual economic sense of the term.

Table 3. Schematic “profit and loss” statement of a cooperative

Marketing service cooperative	Supply service cooperative
Revenues from sale of members’ products to third parties	Revenues: first-wave payments from members
Costs:	Costs:
First-wave payments to members	Paid to suppliers
Operating costs of the cooperative	Operating costs of the cooperative
Revenues-Costs=	
Gross income (surplus/deficit)	
Less allocation to reserve fund and other funds	
Less distribution in proportion to share contribution (паевые выплаты, ”dividends”)	
Difference available for distribution as patronage refunds (кооперативные выплаты)	

Cooperatives do not know in advance, at the time of the actual transaction, how much to pay to members for product deliveries and how much to charge for input supplies and other services. Financial settlements with members are handled in two waves: the first-wave payments and charges are in the nature of an initial advance, and the final settlement is made at the end of the period, when the cooperative financial statements have been prepared. As a result, a service cooperative usually presents a financial statement that shows a positive surplus (accounting profit) or a deficit (accounting loss) according to the scheme in **Table 3**.

Gross income (*dokhod* in Russian) represents the surplus or deficit that is further allocated via three channels:

- 1) Allocation to the cooperative reserve fund or other capital funds (“retained earnings” in standard accounting terminology).
- 2) Distribution to members in proportion to their share contribution to the cooperative capital (“dividends” in standard Western terminology; *paevye vyplaty* in Russian).
- 3) Patronage refunds (*kooperativnye vyplaty* in Russian) in proportion to members’ use of cooperative services (i.e., basically in proportion to first-wave payments to the members).

The sum of the three amounts distributed to members is equal to gross income. Patronage refunds are determined as the difference between gross income and the first two allocations.

Conventional interpretation of the tax code will require the cooperative to pay tax on the full gross income at applicable rates. Recognition of the special nature of patronage refunds in cooperatives (as second-wave adjustment of initial over- or under-payment to members) suggest that this component of gross income should not be taxable. This is the essence of the principle of “fiscal transparency” applied to cooperatives in the Netherlands, where transactions between members and their cooperative are exempt from all taxes. Furthermore, the U.S. tax code recognizes “dividends” paid to members in agricultural cooperatives (but

not other cooperatives) as non-taxable at the cooperative level, i.e., exempt from withholding taxes (Autry and Hall, 2009). If the Dutch and the U.S. tax principles are adopted, the cooperative will be required to pay tax only on the share of gross income retained in reserve fund and other capital funds. The amount retained in the reserve fund and other capital funds will be shown net after deduction of the appropriate taxes.

Value added tax (VAT) and cooperatives. In buy-and-sell transactions between legal bodies, the seller (a peasant farmer, say) charges VAT on his sale and the buyer will deduct from his ultimate VAT liability the amount of VAT charged by the seller. Thus, the buyer will pay the seller \$100 for his tomatoes plus \$20 VAT. Reselling the tomatoes for \$110, the buyer will add \$22 VAT, but his net VAT obligation will be only \$2 (\$22 less \$20 paid to the original seller). If, however, the seller is a physical body (a smallholder not registered for tax purposes), he does not pay VAT and charges the buyer \$100 for the tomatoes, without adding VAT. In this way, when the buyer – a legal body – sells the tomatoes for \$110 plus \$22 VAT, there is nothing to offset against this VAT and the seller’s actual VAT obligation is \$22. The buyer will naturally attempt to charge this extra “cost” back to the original seller, paying less than \$100 for the tomatoes. The smallholder is thus at a clear disadvantage when selling his products to a legal body (e.g., a cooperative).

A similar chain can be traced for purchase transactions. The seller of inputs (a cooperative) charges VAT on the sale transaction. A peasant farmer (legal body registered for tax purposes) can offset the amount of VAT against his cumulative VAT obligations. For a smallholder, on the other hand, the actual cost is the cost of input plus the amount of VAT, which he must absorb. A smallholder would be better off by dealing with a small private supplier who does not charge VAT rather than with the cooperative.

The only fair way to deal with the VAT issue is to exempt all transactions between cooperative members and the cooperative from VAT altogether. Cooperative laws and the Tax Code should recognize that cooperative members do not sell their production to cooperatives, but only transfer it to the cooperative for marketing. In this respect, the cooperative is an extension of the farm itself.

Ukraine: Taxation of cooperatives

Beginning in 2013 the Ukrainian law on agricultural service cooperatives explicitly recognizes the non-profit status of service cooperatives.⁶ However, the Ukrainian Tax Code still does not recognize the non-profit status of these cooperatives. Thus, agricultural service cooperatives are required to pay profit tax on their gross income (see **Table 3**), like other legal entities, such as joint stock companies. A partial solution to this issue (introduced into the Tax Code on 1 January 2013) was reached according to which the profit tax for service cooperatives is assessed on its net income after subtracting all “mandatory and dividend

⁶ Ukrainian law “On changes to Ukrainian law On Agricultural Cooperation” № 5495-VI (20 November 2012).

payments,”⁷ meaning that the profit tax is assessed on the net income available for distribution as patronage funds. This compromise still subjects farmers who join cooperatives to double taxation, but the tax base has been reduced considerably. A bill to amend the Tax Code to ensure that agricultural service cooperatives are considered non-profit entities was introduced into the Ukrainian Rada in March 2012 by the Communist parliamentary faction, but has not been passed.

Service cooperatives, like all legal bodies, are subject to VAT in Ukraine, including VAT on transactions with their members. Thus, in Ukraine smallholders are at a disadvantage when buying and selling from cooperatives, as described in the previous section.

A further disincentive to join a cooperative is that by joining a service cooperative any agricultural producer that is a legal person risks losing the tax benefits that accrue by virtue of its agricultural producer status. This risk is a powerful disincentive for agricultural producers to buy and sell through agricultural service cooperatives. The status of service cooperatives as legal persons subject to both profit taxes and VAT sets them apart from agricultural producers, which since 1998 have been subject to a special tax regime that leaves them nearly untaxed. The two elements of the special regime for agriculture are the fixed agricultural tax (FAT) and the agricultural VAT (AgVAT). The FAT is a flat rate tax introduced in lieu of profit, land and a number of other taxes. Its rate varies from 0.09 to 1% of the normative value of farmland, depending on farmland’s type and location. In 2010, the FAT resulted in an average tax payment of roughly 6 UAH/ha (0.75 USD/ha). This meant that farm profits in Ukraine were virtually untaxed (Nievskiy, 2012). Under the AgVAT agricultural producers accumulate their own VAT payments, but do not transfer them to the government. Instead, they are required to deposit VAT payments in a special account to use for their own input purchases, such as for farming equipment and seeds. Thus, the AgVAT allows agricultural businesses to virtually avoid VAT payments (Nievsky, 2012).

Kazakhstan: Taxation of cooperatives

The current Tax Code introduces a so-called “special tax regime” for agricultural producers (enterprises and peasant farms) and specifically also for agricultural (or rural) service cooperatives. Legal entities opting for the special tax regime are understood to be small agricultural producers. They are entitled to follow a highly simplified tax-return system, with minimum accounting requirements, and in addition they pay only 30% of the standard tax rate on all basic taxes (primarily VAT and corporate income tax, as well as land tax, land lease payments to the state, property tax, social tax, vehicle tax). Since the tax code explicitly puts agricultural service cooperatives in the same category with other agricultural producer, there are no blatant tax distortions for cooperatives. Possible distortions may arise for operators of household plots. They only pay personal income tax and their agricultural

⁷ Allocations made to reserve funds and other funds and payments made as share contributions (dividends). See above **Table 3** for explanation. Law of Ukraine “On changes to the Tax Code of Ukraine for regulation of certain taxation issues,” (2 October 2012) no. 5412-VI.

activities are exempt from taxes. If they join a service cooperative, the cooperative – a legal entity – will be obligated to calculate VAT on their transactions, albeit at the concessionary rate.

Another possible distortion stems from Article 448 (para. 3) of the Tax Code (Conception, 2012). According to this curious article, a rural service cooperative is not entitled to follow the special tax regime if its members are at the same time members of another service cooperative or if it has subsidiary enterprises. This provision was originally intended to preclude large agricultural enterprises from enjoying the special-regime tax concessions, but it has run into vocal opposition. In the past, Article 448 was suspended once for the 2010 tax year and it is now again a bone of contention between agricultural tax payers and the government.

Conclusion

This short review of the status of agricultural service cooperatives in Kazakhstan and Ukraine has shown the difficulties encountered by governments in the region in encouraging the formation of agricultural service cooperatives. While there appears to be widespread recognition by governments of the usefulness of cooperatives, policies designed to support them focus on subsidies for input purchases and subsidized loans. While these policies have been of some help to some, they also seem to have bred a class of “false cooperatives”, i.e., established only for the purpose of gaining access to subsidized credits and inputs, without any regard for true cooperative principles.

Furthermore, neither government has succeeded in creating a supportive business environment for this specific self-help organization. Tax disincentives in both countries are an important reason for lagging numbers of working cooperatives. Though the profit tax issue was mostly overcome in Ukraine at the end of 2012, the VAT system in both Ukraine and Kazakhstan discriminates against smallholders making service cooperatives unattractive for precisely the set of farms for which these organizations can be most helpful. In Ukraine, moreover, even farms that are legal entities risk their special tax status by buying or selling through service cooperatives.

Finally, neither government has really dealt with the important issue of informing the rural population on the cooperative idea and its benefits. In Ukraine this issue was mentioned as perhaps the most important issue by the participants of the All Ukraine Public Meeting “Ukraine on the Eve of the International Year of Cooperatives” (15 December 2011) attended by service cooperative leaders, regional cooperative activists, as well as researchers, government employees and project personnel connected with development of cooperatives (Korinets, 2013:17). Cooperative Development Centers in the United States are an example of the type of government-private sector collaboration that can accomplish this task. Cooperative Development Centers are non-profit state-level organizations funded by cooperatives themselves and co-funded by the US Department of Agriculture. Their function is to explain the cooperative idea and the specific benefits for those interested, to train in cooperative management skills, and support the public with the business, legal and tax

information needed for cooperative startups and management. They also offer individual technical assistance by qualified experts, the costs of which may be covered by the US Department of Agriculture grants for the development of cooperatives.

While the type of public-private partnership represented by the US Cooperative Development Centers is an excellent example of an institution to support the development of cooperatives, there is no substitute for a grass-roots cooperative *movement* driven by enthusiasm for the cooperative model. It is the *movement* in countries around the world that was responsible for building agricultural service cooperatives far before they became a part of state policy. The cooperative movement in Ukraine and Kazakhstan from all appearances, seem to be at an early stage, perhaps understandable for countries that only twenty years ago knew only the Soviet model of cooperation.

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