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# Reconceiving Cooperatives: The Case of Ethiopia

By

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### Declaration

I declare that this is my original work under the supervision of Professor Lorraine E. Talbot and that it has not been submitted either in part or in full for any Degree to this or any other University.

Mesganaw Kiflew Woldie

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## ***Abstract***

*This research argues that cooperatives have become uncategorizable in terms of their identity, especially when one attempts to distinguish them from investor-owned firms and hence it is further argued that they should have specified objectives that match with their historical not-for-profit objectives so that they can easily distinguishable. The cooperatives have become uncategorizable mainly due to the gradual adaptation of the idea of investor owned firms into cooperatives and the possibility of organizing business enterprises in the form of cooperatives. The problems are further exacerbated in Ethiopia due to (1) the existence of state incentives to cooperatives,(2) the legislative failure to properly define cooperatives,(3) the policy failure to properly define cooperatives objectives (4) the absence of state regulation of cooperatives or self- regulation by the cooperatives themselves. Cooperatives could easily be categorized if they have specified objectives that match with their historical not-for-profit objectives. Historically, they were intended to solve problems left unsolved by market forces or state intervention or even the charities. Currently, it is the issue of trust that remains unsolved by these alternatives. Although trust is a foundation of any society, it is an attribute which is in decline due to changing nature of community. Consumer cooperatives are viable alternatives of reviving trust by rebuilding traditional communities in a contemporary world.*

*This argument is advanced by reviewing academic writings and critically analyzing the Cooperative Society Proclamation No. 147/1998 in comparison to the Commercial Code of Ethiopia. This is further followed by critical examination of policy documents of the Federal Government of Ethiopia concerning cooperatives. The actual motives and practical regulation of Ethiopian Cooperatives are evaluated on the basis of interviews. Academic literature is used to review the importance of trust and the role of the cooperative in safeguarding and rebuilding it.*



## LITERATURE REVIEW

Existing literature on cooperatives may generally be classified into three categories: the first categories are those which analyze the experience of cooperative movement. For the purposes of this part this approach is termed the ‘institutional approach.’ The center of discussion is the cumulative benefit that the cooperatives would give to their members. This approach follows mainly the utilitarian theory of justice. The second approach is those which examine the economic efficiency of the cooperative as a form of enterprise. The central concern with the literature here is the benefit individual members obtain by becoming a member of a cooperative. The theory of rational, economic egoism is the underpinning assumption of the literature here. For the purposes of this part this approach is termed the ‘efficiency approach’. The third approach is those which analyze the role of the cooperative from a sociological perspective. Here the central concern is not the collective benefits to members or the individual benefit, but instead the benefit that society can obtain from a company in a cooperative form. For the purposes of this paper this approach is termed the ‘societal approach.’ The first two approaches concern economic issues and the third approach goes beyond economic concerns and looks towards societal issues.

Most of the literatures on cooperatives are descriptive of the experiences of cooperatives from a historical vantage point and is most relevant to the institutional approach. The literature displays a tendency to see cooperatives as instruments of economic reform that would bring social justice. Their central objective is to energize the new cooperative movement by learning from the legacy and challenges of past cooperative movements.

In Sidney and Beatrice Webb’s book of 1921 on the British consumer cooperative movement, it describes the consumer cooperatives movement with very little attention to the theoretical foundations of the cooperative movement.<sup>1</sup> They appeared to believe that cooperatives would end economic inequality. Similarly, Arnold Bonner’s book of 1961 describes the history of the British Cooperative Movement from 1820s to 1950s.<sup>2</sup> The book is descriptive of the cooperative movement emphasizing the different phases entered into by past movements looking specifically

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<sup>1</sup> Sidney Webb, *The Consumer Cooperative Movement*[1921] (Cornell University Library, 2009)

<sup>2</sup> Arnold Bonner, *British Cooperation: the History, Principles, and Organization of the British Cooperative Movement* (Co-operative Union Ltd, 1961)

at the successes and challenges. The book tends to see cooperatives as the best alternatives to the market economy.

Another book written by Aloysius Balaweyder in 1980 also followed a similar tradition by describing the cooperative movement in Eastern Europe.<sup>3</sup> Four years later, a book entitled *Workers' Cooperatives in America* was published by putting together eleven articles.<sup>4</sup> However, although the titles of some of the articles appear to involve an economic and legal analysis of cooperatives, the overall tendency was to document the experience of the worker cooperative movements. In 1988, Hans Hedlund edited a book entitled *Cooperative Revisited*.<sup>5</sup> This book, like to its predecessors describes the problems and progress of the cooperative movement. It differs from its predecessor only by the fact that its description was on cooperative movements in Africa.

In another book published in 1991 on the French consumer cooperatives by Ellen Furlough (editor), there is an analysis of the consumer cooperative movements from the 1830s through to the 1920s.<sup>6</sup> The book indicates that consumer cooperatives in France were politically galvanized by the working class movement. Ellen Furlough, in collaboration with Carl Strikwerda, also edited another book with a similar theme eight years later.<sup>7</sup> The book describes the historical struggle that consumer cooperatives made against the market economy in Europe, North America and Japan from the industrial revolution to the end of Cold War.

This tradition of writing continued into the new millennium. A book edited by Christopher D. Merrett in collaboration with Norman Walzer and published in 2004 describes cooperatives from a historical point of view.<sup>8</sup> The book is concerned with issues of how cooperatives have responded and should respond to the increasing market economy and intense global economic pressure. However, the book also shows some inclination towards theorizing cooperatives on the basis of the existing domestic and global factors; it attempts to determine the place of

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<sup>3</sup> Aloysius Balaweyde, *Cooperative Movement in Eastern Europe* (1<sup>st</sup> edition, New York: Macmillan, 1980)

<sup>4</sup> Robert Jackall and Henry Levin (eds), *Worker Cooperative in America* (University of California Press, 1984)

<sup>5</sup> Hans Hedlund (ed), *Cooperatives Revisited* (Nordic African Institute, 1988) 223

<sup>6</sup> Ellen Furlough (ed), *Consumer Cooperation in France; The Politics of Consumption: 1834-1930* (The American Historical Review, 1992)

<sup>7</sup> Ellen Furlough, and Carl Strikwerda, *Consumer against Capitalism? Consumer Cooperation in Europe, North America and Japan* (Rowman & Littlefield Publishers, 1999)

<sup>8</sup> Christopher Merrett, and Norman Walzer, *Cooperatives and Local Development: Theory and Applications for the 21<sup>st</sup> Century* (M.E. Sharpe, 2004)

cooperatives in a market and globalized economy. In his book of 2005, Richard C. William's argument for economic efficiency and social justice in the organization of cooperatives is based on a historical and practical review of the cooperative movements in different parts of the world. His analysis of cooperatives in comparison with more competitive, and economic self-seeking companies forms part of his argument that Cooperatives should also be seen as part of political economic theory. This is the first recorded mention of cooperatives in this form with the only previous mention by Robert Owen and the British Labour Economists of the 19th Century who had argued for cooperatives as an alternative to market economy driven companies.<sup>9</sup> In a similar vein, a book edited by Lawrence Black and Nicole Robertson published in 2009, is the result of historical research although there are other articles which have seen cooperatives historically from different ideological perspectives.<sup>10</sup>

The economic efficiency approach also attempts to evaluate cooperatives in an economic perspective. Property rights, agency and game theory are major themes of the literature in this area. In this respect, Richard J. Sexton's article entitled "*The Formation of Cooperatives: A Game-Theoretic Approach with Implications for Cooperative Finance, Decision Making, and Stability*" and published in 1986 has been an influential publication.<sup>11</sup> In contrast with the institutional approach, it examines the incentives of individuals to form cooperatives. It applies game theory to justify producer cooperatives. The author also published a similar article a year later in collaboration with Richard and Terri Sexton.<sup>12</sup> This article argues that game theory also applies to consumer cooperatives. A book entitled *Cooperatives in Agriculture* edited by David W. Cobia and published in 1989 also contains topics on cooperative economic and marketing theories.<sup>13</sup> These topics review the economic justifications of the cooperative as a form of economic organization, and development of cooperative game theory. The other topics the book

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<sup>9</sup> Bonner (n 3) 10, and Peter Davis and Martin Parker, 'Cooperatives, Labor, and the State: The English Labor Economists Revisited' (2011) *Review of Radical Political Economics* <<http://rrp.sagepub.com/content/39/4/523.full.pdf+html>> accessed on 30 January 2015, 522.

<sup>10</sup> Lawrence Black and Nicole Robertson (ed), *Consumerism and the Cooperative Movement in Modern British History-Taking Stock* (Manchester University Press, 2009)

<sup>11</sup> Richard Sexton, 'The Formation of Cooperatives: A Game-Theoretic Approach with Implications for Cooperative Finance, Decision Making, and Stability' (1986) 68(2) *American Journal of Agricultural Economics* <<http://ajae.oxfordjournals.org/content/68/2/214.full.pdf+html>> accessed 30 January 2015, 214-225

<sup>12</sup> Richard Sexton and Terri Sexton, 'Cooperatives as Entrants' (1987) 18(4) *RAND Journal of Economics* <<http://www.jstor.org/discover/10.2307/2555643?sid=21105155657961&uid=2&uid=3739256&uid=4>> accessed 30 January 2015, 581-595

<sup>13</sup> David Cobia (ed), *Cooperatives in Agriculture* (Prentice-Hall, 1989)

considers include the cooperatives as an alternative form of economic organization. A book edited by Christopher D. Merrett in collaboration with Norman Walzer and published in 2004 also contains topics that discuss cooperatives in relation to game theory.<sup>14</sup>

Some of the literatures analyze the role of cooperatives in community building. In 1963, William P. Lebra and Thomas W. Maretzki described and analyzed the role cooperatives played in building peasant communities in East Asia, Indonesia, and the Philippines.<sup>15</sup> Leslie H. Brown's article of 1997 considers cooperatives as a 'new' form of organization for community economic development.<sup>16</sup> In an online publication of 2011, Wilson Majee and Ann Hoyt also argued that cooperatives are indispensable in building local community necessary to fight poverty.<sup>17</sup> Dave Nicholson in his online publication of 2011 also argued that cooperatives would even be able to reduce crime.<sup>18</sup> Stephen Yeo's argument in his article published in 2009, shows that cooperatives are the contemporary substitute of professional associations that were anticipated by Emile Durkheim as a source of modern social solidarity.<sup>19</sup> There are very few papers in the literature that attempt to see cooperatives from a theory of justice perspective.<sup>20</sup>

However, there are a few papers in the literature that analyze cooperatives from a theoretical point of view; theorizing that cooperatives are less abundant especially from the perspective of political economic theory. More importantly, some of the literature gives very less attention to the distinction of cooperatives from similar organizations; especially the distinction from investor owned firms. The only work this research has found in this regard is the article by Mark

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<sup>14</sup>Merrett (n 9)

<sup>15</sup> William Lebra and Thomas Maretzki, 'The Community Cooperative in Northern Okinawa' (1963) 11(3) Economic Development and Cultural Change  
<<http://www.jstor.org/discover/10.2307/1152346?sid=21105155657961&uid=2&uid=3739256&uid=4>> accessed 30 January 2015, 225-238

<sup>16</sup> Leslie Brown, 'Organizations for the 21st Century? Co-operatives and 'New' Forms of Organization' (1997) 22(1) The Canadian Journal of Sociology  
<<http://www.jstor.org/discover/10.2307/3341564?sid=21105155657961&uid=2&uid=3739256&uid=4>> accessed 30 January 2015, 65-93

<sup>17</sup> Wilson Majee and Ann Hoyt, 'Cooperatives and Community Development: A Perspective on the Use of Cooperatives in Development' (2011) 19(1) Journal of Community Practice  
<<http://devstudies.wisc.edu/docs/Majee%20and%20Hoyt.pdf>> accessed 30 January 2015, 48-61.

<sup>18</sup> Dave Nicholson, 'Co-operating out of crime?' (2010) 81(1) Criminal Justice Matters  
<<http://www.tandfonline.com/doi/pdf/10.1080/09627251.2010.505385>> accessed 30 January 2015, 16-17

<sup>19</sup> Black (n 12)

<sup>20</sup> Stuart Henry, 'Community Justice, Capitalist Society, and Human Agency: The Dialectics of Collective Law' (1985) 19(2) Cooperative Law & Society Review, 303-327

J. Hanson.<sup>21</sup> In his analysis of cooperative legal structure in America, he showed the distinction between traditional cooperatives and profit-motivated cooperatives. Researchers who have looked at the role of cooperatives in building community, especially for non-economic purposes, is scarce.

The cooperative literatures from Ethiopia focus on the institutional approach and are descriptive of practical functioning of producer cooperatives. What is peculiar about those papers is that they appear to advocate increasing state support for cooperatives. They also advocate greater autonomy for cooperatives without giving adequate consideration to the dependency and wasteful rent-seeking nature cooperatives here are known for. They unduly place too much responsibility on the Government to support the functional needs of the cooperatives. Producer cooperatives, as discussed in the above papers, heavily utilize marketing which is considered a key target of producer cooperatives. For example, the article written by Yuka Kodama published in 2007, analyses the financial constraints that coffee farming cooperatives have been facing.<sup>22</sup> Woldegebrail Zeweld Nugussie's article of 2010 limits itself to identifying information factors that induce rural people to join agricultural cooperatives.<sup>23</sup> Kindie's article written in collaboration with Tsegaye and published in 2012, is about the positive influence of cooperatives on the livelihood of its members.<sup>24</sup> There is a lack of publications surrounding the efficiency approach to cooperative building, especially regarding the role of cooperatives in community building, the place of cooperatives in political economic theory, the legal framework, and the distinction between true cooperatives and investor-owned cooperatives.

This research attempts to fill the gap by trying to conceptualize cooperatives from a theoretical perspective by looking at them from the perspective of political economic theory, especially by

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<sup>21</sup> Merrett (n 9) 95-122

<sup>22</sup> Yuka Kodama, 'New Role of Cooperatives In Ethiopia: The Case Of Ethiopian Coffee Farmers Cooperatives' (2007) African Study Monographs <[http://repository.kulib.kyoto-u.ac.jp/dspace/bitstream/2433/68489/1/ASM\\_S\\_35\\_87.pdf?origin=publication\\_detail](http://repository.kulib.kyoto-u.ac.jp/dspace/bitstream/2433/68489/1/ASM_S_35_87.pdf?origin=publication_detail)> accessed 30 January 2015, 87-108

<sup>23</sup> Woldegebrail Zeweld Nugussie, 'Why some rural people become members of agricultural cooperatives while others do not' (2010) 2(4) Journal of Development and Agricultural Economics, 138-144

<sup>24</sup> Getnet Kindie and Tsegaye Anullo, 'Agricultural Cooperatives And Rural Livelihoods: Evidence From Ethiopia' (2012) 83(2) Annals of Public and Cooperative Economics <[http://www.fearp.usp.br/cooperativismo/up\\_arquivo/8740ddf6d01.pdf](http://www.fearp.usp.br/cooperativismo/up_arquivo/8740ddf6d01.pdf)> accessed 30 January 2015, 181-198

comparing them with investor-owned firms and attempting to anchor them into building the trust necessary to support the rule of law.<sup>25</sup>

Since this research intends to anchor the cooperative into building trust through social solidarity, a short review of literature on trust is necessary. I have chosen to assess five authorities in this area; Emile Durkheim, Pierre Bourdieu, James Coleman, Robert Putman, and Francis Fukuyama as set out by John Field in *Social Capital*.<sup>26</sup> Durkheim argued that social solidarity maintains social stability and reduces individual anxiety, and he proposed professional associations as an instrument to build social solidarity. Pierre Bourdieu believed that social solidarity/relation is one source of inequality between individuals and advocates that economic equality can not be ensured by equal opportunity alone unless people are made to have similar social capital. James Coleman writes about the role of social solidarity for child education while Putman writes about the importance of trust in government administration and believes that trust is the result of solidarity. In contrast to this, Fukuyama argued that trust is indispensable in establishing economic efficiency.

However, none of them give their attention to the role of trust in ensuring the rule of law. More importantly, with the exception of Emile Durkheim they have not indicated how to build social solidarity or trust within a society. Durkheim anticipated professional associations but since such associations have not materialized in Ethiopia, Yeo argues that cooperatives should be the contemporary substitute.<sup>27</sup> This research shares their ideas on the importance of social solidarity and trust, but adds that their importance goes beyond the issue of health, equality, education, economy and crime control and extends to the rule of law- and becomes the foundation of a human relationship. The research shares Putman's idea that to build trust you must build social solidarity and the research joins Yeo in the argument that social solidarity could be built through community consumers cooperatives.

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<sup>25</sup> "By the phrase "the rule of law", I mean nothing more and nothing less than the state of affairs that obtains when a legal system exists and functions." See Matthew H. Kramer On the Moral Status of the Rule of Law The Cambridge Law Journal, Vol. 63, No. 1 (Mar., 2004), pp. 65-97 <http://www.jstor.org/stable/4509076>

Accessed: 10/08/2011

<sup>26</sup> John Field, *Social Capital* (2<sup>nd</sup> edition, Routledge, 2008) 13-47, 61

<sup>27</sup> Black (n 12) 86-106



# INTRODUCTION

Cooperatives have become uncategorizable in terms of their identity, especially when one attempts to distinguish them from investor-owned firms. This has partly been due to the attainment of multiple not-for-profit objectives in contemporary cooperatives, and an expansion in the number of initiators of the cooperative movement. Moreover, the decline of not-for-profit objectives in cooperatives due to change in the role of the State, has forced cooperatives to place greater emphasis on profit as an objective. Entrepreneurs have also realized that businesses may be organized as cooperatives and with the existence of state incentives for cooperatives; this has also opened the floodgates for pseudo-cooperatives to emerge. The legislative and policy failure of Government to properly define cooperatives has exacerbated the problem in Ethiopia.

To more clearly define their identity, cooperatives should have specified objectives that match its historical not-for-profit objectives. Historically, cooperatives were intended to solve problems left unsolved by other alternative forms of human associations. Currently, the issue of building trust within communities remains unsupported by natural market forces, the state or the work of charities.

This research is divided into eleven chapters. Chapter one shows that cooperatives have been utilized to attain multiple objectives that have largely been initiated by their own members, the state and charities. This chapter also shows the decline of not-for-profit objectives in cooperatives due to changing role of the state. Chapter two looks to demonstrate the increasing trend of entrepreneurs to organize companies in the form of cooperatives.

Chapter three to five look to demonstrate that the legislation in Ethiopia is insufficient to distinguish cooperatives from investor-owned firms. This is done by comparing cooperative law in Ethiopia with the Commercial Code of Ethiopia that governs investor-owned firms. Chapter three compares the definition, objectives, privileges, formation process and the liability of cooperatives with investor-owned firms. Chapter four examines the principles of cooperatives. In Chapter five, ownership and management of cooperatives are examined to see if they can restrain pseudo-cooperatives. Chapter six to eight seek to show that in Ethiopia neither the policy nor practice distinguishes cooperatives from investor-owned firms; there is no cooperative policy



and in practice, cooperatives are concerned with profit-maximization and there is no mechanism to restrain or redirect this motive towards not-for-profit objectives.

Chapter nine proves that although trust, which is indispensable for the rule of law (which in turn is the foundation of human relationships), is declining, the state, the market and charities have not come to rescue it. Then chapter ten proposes that cooperatives should take the responsibility of rescuing trust.

Finally, the conclusion and recommendation of this paper is that the ultimate objective of cooperatives should be limited to rebuilding traditional community in a way suitable to contemporary life.

# **CHAPTER ONE**

## **NOT-FOR-PROFIT MOTIVES OF THE COOPERATIVE MOVEMENTS AND THEIR DECLINE**

### **1.0 Introduction**

This chapter has two points to address. The first point is to review why the ultimate objectives of true cooperatives have been not-for-profit motives. The second point is to show how not-for-profit motives have been declining due to a change in political ideology; partly due to the emergence of efficient investor-owned hypermarkets, consumer associations and management challenges.

The chapter has two major topics; the first sub-topic is the not-for-profit motives of the cooperative movement. This topic has three subtopics: movement from below, movement from above and movement from side. The second topic is the decline of the not-for-profit motives of the cooperative movement.

## 1.1 Not-for-profit motives of cooperative movements

The ultimate motives of 'true' cooperatives have been economic self-help, community building, cultural and economic transformation and charity. All of them are not-for-profit motives.

### A. Movement from below: self-help movements

Self-help movements were concentrated in the West and mainly intended to solve economic challenges of members that came as a result of ill-effects of the market economy. These movements were strong in the second half of nineteenth century and the first half of twentieth century. However, there have also been cooperative movements intended to community build.

#### Economic self-help movements

Economic self-help movements have been dominant in North America, Britain and Continental Europe. The producer cooperatives of small hold producers are major features of cooperative movements in North America while the consumer cooperative movement has been the dominant movement in Britain and worker cooperatives have been dominant in Continental Europe.

#### *Producer Cooperatives of North America*

Cooperatives have been a fundamental part of North American economic activity, especially in agriculture in the form of small hold producer cooperatives.<sup>1</sup> They emerged as part of a sweeping socio-economic transformation aimed at changing the lives of countless people in North America throughout the past two centuries.<sup>2</sup> However, the cooperatives neither caused the basic transformation of North American society in the nineteenth century, nor opposed such transformation, rather they aimed to guide the transformation and protect the people involved from the ill-effects of that transformation.<sup>3</sup> Economic stress and change due to the industrial revolution was the driving factor.<sup>4</sup> The nineteenth century North American farmers were exposed to market fluctuation, monopolistic abuse and technological change.<sup>5</sup> The cooperatives were a

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<sup>1</sup>David Cobia, *Cooperatives in Agriculture* (Prentice-Hall, 1989) 110

<sup>2</sup> Christopher Merrett and Norman Walzer (eds), *Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century* (ME Sharp, 2004) 23

<sup>3</sup> Ibid

<sup>4</sup> Ibid

<sup>5</sup> Ibid 30

response to these challenges.<sup>6</sup> Agricultural producers' were using cooperatives as self-help business alternatives.<sup>7</sup> There was also a political reason for the emergence of these self-help cooperatives.<sup>8</sup> The farmers were using their cooperatives as a medium to oppose urban centered policies.<sup>9</sup> "Political and cooperative actions were intertwined at every stage; farmers' organizations, political parties and cooperatives developed in synergy with one another."<sup>10</sup> In fact, "prior to World War I, farmer cooperatives were enmeshed in a broad agrarian reform movement that included important political and cultural dimensions."<sup>11</sup>

The emergence of big corporations, democratic politics and the modern state in the twentieth century further led to the evolution of cooperatives in a more organized and systematized manner.<sup>12</sup> In the twentieth century, although the Government started to support cooperatives, farmers were still left to organize many of the responsibilities of the cooperative including its marketing.<sup>13</sup>

#### *The consumer cooperatives of Britain*

In Britain, Robert Owen had established a village of cooperatives to develop a moral community. The so called 'Owenites' aimed to make workers in the cooperative movement free from exploitation. Although both movements did not succeed, they influenced the emergence of the consumer cooperative movement. The consumer cooperatives were in fact started by the 'Rochdale pioneers'.

The influence of Owen and the Owenites and the economic situation of 1840s was the driving factor for the emergence of the consumer cooperative in Rochdale. The political and economic situation in Europe and England was bad in the 1840s.<sup>14</sup> More importantly, Rochdale weavers were seriously affected as a result of the industrial revolution and brought about repeated strikes

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<sup>6</sup> Ibid 29

<sup>7</sup> Cobia (n 2) 112

<sup>8</sup> Ibid

<sup>9</sup> Ibid 23

<sup>10</sup> Ibid 31

<sup>11</sup> Ibid 32

<sup>12</sup> Ibid

<sup>13</sup> Ibid

<sup>14</sup> Hebe Spaul, *The Cooperative Movement in the World Today* (1<sup>st</sup> edition, Barrie and Rockliff, 1965) 17

but without success.<sup>15</sup> It was against this back drops that the twenty-eight ‘pioneers’ in Rochdale, Northern England, established in 1844 a cooperative store and named it the Rochdale Equitable Pioneers Society.<sup>16</sup> The memberships were made up of diverse artisans including, ‘weavers, wool sorters, a cloggiar, a cabinet maker, a tailor, a joiner, a hatter and a shoe maker.’<sup>17</sup> In relative terms most of them were well-paid, skilled and some of them had their own private business.<sup>18</sup> Their immediate objective was “to free themselves from adulteration and the credit system of the little shop keepers and the ‘truck shop’ of the employer.”<sup>19</sup> They also had the ultimate goal of emancipating themselves “from wage earning slavery by such reorganization of industry as would enable them to provide themselves with employment.”<sup>20</sup> To that effect, they immediately developed a system of cooperation which was modelled on the basis of their own interest. Unlike Owen and the Owenites they gave little attention to philanthropy.<sup>21</sup>

Accordingly, they started by collectively purchasing the groceries, draperies and household requisites that their family needed and dividing these commodities among themselves.<sup>22</sup> The cooperative was able to distribute a dividend to its members within a year. Their success drew many persons to the society and those who were remote from Rochdale began to imitate the Rochdale Pioneers.<sup>23</sup> Generally, the Rochdale Society of Equitable Pioneers is a model of many modern cooperatives in all corner of the world. <sup>24</sup>More particularly it could be termed as the mother of modern cooperative stores.<sup>25</sup>

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<sup>15</sup>Arnold Bonner, *British Cooperation The History, Principle and Organization of the British Cooperative Movement*(Co-operative Union Ltd, 1961) 43

<sup>16</sup>Jenny Thornley, *Workers’ Cooperatives: Jobs and Dreams* (1<sup>st</sup> edition, Heinemann Educational Publishers, 1981)

<sup>19</sup>

<sup>17</sup>Ibid

<sup>18</sup> Bonner (n 16) 45

<sup>19</sup>Sidney Webb, *The Consumers’ Co-operative Movement* (Cornell University Library, 1921) 1

<sup>20</sup>Ibid

<sup>21</sup> Thornley (n 17) 19

<sup>22</sup>Webb (n 20) 2

<sup>23</sup> Spaul(n 15) 18

<sup>24</sup>Robin Thornes, ‘Change and Continuity in the Development of Cooperation 1827-1844’(1988) *New Views of Cooperation* 48

<sup>25</sup>Malcom Bee, ‘Unity, Industry, Plenty: The Banbury Co-Operative Society, 1866-1970’ (2011) *Midland History* 136

The success of the Rochdale Society of Equitable Pioneers coupled with consumers' dissatisfaction, facilitated the flourishing of retail cooperative societies.<sup>26</sup> In the middle of nineteenth century "retailing costs were high, price competition was weak, and customers rarely had an effective choice between more and less elaborate and costly methods of retailing."<sup>27</sup> Adulteration and joint price fixing was very common.<sup>28</sup> "The 1860s saw the spread of co-operation over much of the country and in any urban area it was almost inevitable that somebody would eventually bring forward a co-operative scheme."<sup>29</sup> Accordingly "between 1862 and 1888 the number of separate consumer retail societies appears to have risen from about 400 to about 1200 with an aggregate membership of less than 900,000."<sup>30</sup> The growth of retail cooperative societies did also include increases in capital, trade and profit.<sup>31</sup> The size of retail cooperative societies further led to sectionalisation and departmentalization of trade.<sup>32</sup> Retail cooperative stores normally began with limited type of foodstuffs and gradually embraced other commodities depending on the interest of their member consumers and their financial capacity.<sup>33</sup> Later they were used for bakeries, tailoring, dressmaking, furniture making, boot making and repairs, farming and many others.<sup>34</sup>

### *Worker Cooperatives in Continental Europe*

The worker cooperative movement was attempted in Britain by labour economists, Christian democrats and trade unionists, but despite their efforts all of these movements' failed. Owenite communities and self-help business enterprises were established by the workers to liberate themselves from capitalism.<sup>35</sup> They began to develop in the 1820s and reached their climax between 1835 and 1846.<sup>36</sup> In the 1850s a few Christian lawyers and clergymen reintroduced a

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<sup>26</sup>Victoria Kelley, 'The Equitable Consumer: Shopping at the Co-op in Manchester' (2011)11(4) Journal of Design History <<http://jdh.oxfordjournals.org/content/11/4/295.full.pdf+html>> accessed 30 January 2015, 295

<sup>27</sup>Julia Hood and B. Yamey, 'The Middle-Class Co-Operative Retailing Societies In London 1864-1901'(2011)9(3) Oxford Economic Papers <<http://www.jstor.org/discover/10.2307/2661800?sid=21105186495971&uid=3739256&uid=4&uid=2>> accessed 30 January 2015, 308

<sup>28</sup> Ibid

<sup>29</sup> Bee (n 25) 138

<sup>30</sup> Webb (n 20) 16

<sup>31</sup> Bonner (n 16) 99-101

<sup>32</sup>N Barou(ed),The Cooperative Movement in Labour Britain (Left Book Club Gollancz, 1948) 31

<sup>33</sup> Bee (n 26) 137

<sup>34</sup> Bonner (n 16) 102

<sup>35</sup> Thornley (n 17) 16

<sup>36</sup> Ibid 15, Bonner (n 16) 39

philanthropic concept of worker cooperatives and began to preach that all the miseries of the time were due to the neglect of the Christian obligations of love and friendship.<sup>37</sup> But the movement was unsuccessful.<sup>38</sup> By the time such lack of success was attributed to the lack of cooperative knowledge on the part of the promoters that led them to over-optimistic assumption of human nature<sup>39</sup> (the promoters (Christian Socialists) did not have any knowledge on social science, on the life of industrial preliterate and on “even earlier and contemporary cooperative efforts” in England.<sup>40</sup>), and to bad behaviours of co-operators that led to serious disputes between co-operators themselves and managers.<sup>41</sup> After an 1880 initiative to establish worker cooperatives, societies began to come from trade unionists.<sup>42</sup> However, in the 1900s the worker cooperatives were generally declining.<sup>43</sup>

Worker cooperatives have been more successful in Continental Europe. The most prominent example has been the Mondragon Cooperatives Corporation in Spain.<sup>44</sup> The Mondragon Cooperatives were established to create enterprises where people are more important than capital, and their results are to be directed to improve the quality of life of the community.<sup>45</sup> Their ultimate objective was to build a new model of social, humane, and democratic organization which would contribute to the social and economic welfare not only of the cooperative workers and their families, but also of the population at large.<sup>46</sup> The Mondragon Cooperatives Corporation has passed through four major historical phases. The first phase was the inception, the indoctrination of the idea and the capacity building of the workers through technical training.<sup>47</sup> The second phase was from 1955 to 1970 where the first cooperatives and auxiliary institutions began; the third was during the 1970s and 1980s when cooperatives were according to geographic proximity and when a process of productive restructuring was begun,

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<sup>37</sup>Thornley (n 17) 21

<sup>38</sup> Robert Oakeshott, *The Case for Workers' Coops* (2<sup>nd</sup> edition, Palgrave Macmillan, 1978) 58

<sup>39</sup> Ibid 54-55

<sup>40</sup> Ibid. 54

<sup>41</sup> Ibid 55

<sup>42</sup> Ibid 63

<sup>43</sup> Ibid 65

<sup>44</sup> Ana Johnson and William Whyte, ‘The Mondragon System of Worker Production Cooperatives’ (1977) 31(1) *Industrial and Labor Relations Review* 18-30

<sup>45</sup> Alessandra Azevedo and Leda Gitahy, ‘The cooperative movement, self-management and competitiveness: the case of Mondragon corporation cooperative (2010) 13(1) *Working USA: The Journal of Labor and Society* 9

<sup>46</sup> Ibid

<sup>47</sup> Henk Thomas and Chris Logan, *Mondragon: An Economic Analysis* (Allen and Unwin, 1982) 17

and the fourth phase began in the 1990s, with the formation of the corporation, internationalization, and departmental reorganization.<sup>48</sup>

The Italian worker cooperatives are the largest and fastest growing systems of worker cooperatives in industrialized Western economies.<sup>49</sup> Agricultural land worker cooperatives have been the most prominent and successful types of worker cooperatives in Italy.<sup>50</sup> These Cooperatives were formed by farm workers who were unable to secure permanent employment for themselves, and then were driven to form a cooperative in order to lease, buy or reclaim land to work on.<sup>51</sup> The first successful cooperative farm was founded at Ravenna in 1886.<sup>52</sup> Others followed with increasing frequency.<sup>53</sup> The Italian land reform of 1950 further increased farm cooperatives.<sup>54</sup> The farm cooperatives have been either socialistic farming societies which aim to end private property in land and to socialize the means of production, or catholic farming societies which limited themselves to the ultimate objective of 'land to the tiller',<sup>55</sup> or agricultural technology distribution cooperatives.<sup>56</sup> After World War II, non-farm worker cooperatives, especially in the construction and manufacturing sectors, also increased.<sup>57</sup> There have also been successful worker cooperatives in France.<sup>58</sup>

### **Community building movements**

Here we very briefly review 'cooperative- like' or cooperative community building that intended to meet different purposes. This is to recognize that cooperatives may have non-economic issues as their ultimate objectives although the economic issue still remains a catalyst for their emergence. These ultimate objectives may be nurturing morality or a necessity to the defense of community.

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<sup>48</sup>Azevedo (n 46) 10

<sup>49</sup> Derek Jones, Jan Svejnar, 'Participation, Profit Sharing, Worker Ownership and Efficiency in Italian Producer Cooperatives' (1985) 52(208) *Economica*, New Series 449

<sup>50</sup>Margret Digby, 'Cooperatives and Land Use' (1957) *Agricultural Development Paper* No.61 7

<sup>51</sup> *Ibid*

<sup>52</sup> *Ibid*

<sup>53</sup> *Ibid*

<sup>54</sup> *Ibid* 23

<sup>55</sup> Define this or delete

<sup>56</sup> Diarmid Coffey, 'The Cooperative Movement in Yugoslavia, Rumania and North Italy' (1922) 71-72

<sup>57</sup> Jones (n 50) 450

<sup>58</sup> Richard Williams, *The Cooperative Movement: Globalization from Below* (Ashgate Publishing Limited, 2007) 1



### *Nurturing ethics*

Plato in his political writings argued that leaders should reside in common and share everything in common, including meals and shelters with the people.<sup>59</sup> Plato believed that such way of life would keep the rulers enlightened with the truth (knowledge) which was the ultimate justice for him.<sup>60</sup> Plato claimed that private property has been the source of many unholy deeds, and corrupt truth. Accordingly, he proposed a 'cooperative-like' institution to strip rulers of property ownership. The next groups of cooperative makers were the early Christians.<sup>61</sup> The Bible describes this institution as follows:<sup>62</sup>

*“The whole body of believers was united in heart and soul. Not a man of them claimed any of his possession as his own, but everything was held in common.....They were all held in high esteem; for they had never a needy person among them, because all who had property in land or house sold it, brought the proceed of the sale and laid the money at the feet of the apostles; it was then distributed to any who stood in need.”*

The sixteenth century Thomas More's fictional utopia could also be taken as a cooperative-like institution.<sup>63</sup> According to Thomas More the political state had to be divided into small communities where works should be performed cooperatively and the members of the village took meals together.<sup>64</sup> This cooperative work and village community life style was thought to be solution to unethical behaviour of human being's desire for wealth.<sup>65</sup>

Robert Owen's village cooperatives of the nineteenth century were in fact cooperative movements that intended to resolve ethical problems as their ultimate objective. According to him, competition led human beings to learn to deceive and be selfish.<sup>66</sup> The employer considered the employee as a mere instrument to maximize his profits and hence increased working hours, cared little about the suitability of the working environment, paid very meagre wages and

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<sup>59</sup>Plato The Republic p.273 <http://www.idph.net>

<sup>60</sup> Ibid

<sup>61</sup>Knowles (ill), *The New English Bible* (Bible Society, 1990) Luke 18:18-25, Mathew 6:19-27

<sup>62</sup> Ibid Mathew 6:19-27

<sup>63</sup>David Wootton (ed), *Utopia with Erasmus's the Sileni of Alcibiades* (Hackett Publishing Company, 1999) 91

<sup>64</sup> Ibid 90-105

<sup>65</sup> Ibid 43

<sup>66</sup> Bonner (n 16) 11

preferred to employ the cheap labour of women and children. Young children were usually employed in mills and mines rather than going to school.<sup>67</sup> As a result of their meagre income, the dwelling house of the working class were very poorly furnished and were uncomfortable to live in.<sup>68</sup> In urban areas, there was no free space for the working class to sit and read newspapers with open areas prohibited for the working class and therefore public houses were solitary places of relaxation and emotional release.<sup>69</sup> Owen sympathized not only with the working class but also with the factory owners. He argued that the competitive system enslaved not only workers but also the factory owners themselves.<sup>70</sup> “Many had little capital and were generally on the brink of failure” and competition was generally a matter of existence since “failure meant a plunge back into the mass of wage earners from which many had painfully climbed.”<sup>71</sup>

He believes that if workers were happier, healthier and received better, character-moulding education they would be more productive.<sup>72</sup> He also believed that crime, misery and poverty were, due to bad character caused and shaped by the competition of the time.<sup>73</sup>

So to help human beings by improving their moral character, he organized his workers in a community consisting of about a thousand persons occupying one thousand five hundred acres of land.<sup>74</sup> They practiced cooperative housekeeping and common training of children.<sup>75</sup> “Buildings were erected in the form of parallelogram enclosing a court yard, and would provide a common kitchen, dinning rooms, lecture rooms, schools, library, workshop, slaughter house, brew house, grain mills and individual quarter for separate families.”<sup>76</sup> It was a self-supporting society although some of its manufactures might be sold outside.<sup>77</sup> The administration of the villages in the cooperative was paternalistic since he believed that workers were unable to determine their own destiny.<sup>78</sup> Summarily, he advocated for his villages as a replacement of capitalism and

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<sup>67</sup> Spaul (n 15) 16

<sup>68</sup> Bonner (n 16) 5

<sup>69</sup> Ibid 5

<sup>70</sup> Ibid 5

<sup>71</sup> Ibid 6

<sup>72</sup> Thornely(n 17) 12

<sup>73</sup> Bonner (n 16) 14

<sup>74</sup> Ibid

<sup>75</sup> Ibid

<sup>76</sup> Ibid

<sup>77</sup> Ibid 13 -14

<sup>78</sup> Thornley(n 17)15

competition and provided the conditions for universal happiness. He proposed to replace the ‘Old Immoral World’ with the ‘New Moral World.’<sup>79</sup>

The common characteristic of Plato, Christian Apostles, More, and Owen was that they believed private property was the cause of moral corruption and hence cooperatives should serve as a means to keep individuals away from private property.

### *Providing collective security*

The word security here means either physical defense of a village community against man-made or natural dangers or ensuring the continuity of culture and language. The cooperatives were also intended to build a community that would serve as a shield for individual members by creating a culture of a community to protect them from those who would seek to divide them up for their own purposes.

European settlers of nineteenth century in North America used cooperatives as a tool to establish themselves as settlers in a world that was new to them.<sup>80</sup> Cooperatives served as a forum for collective action against any dangers that the new settlers could face. Moreover, cooperatives also served as a welcome form of integration against the exclusion by the majority, older immigrants against the minority of new arrivals.<sup>81</sup>

In the case of the cooperatives in Israel, these were instruments in establishing the new state.. From the nineteenth century the Jewish community had faced increasing hostility, violence and finally genocide from their neighbors. Two solutions presented themselves, cultural integration with the neighboring community or immigration to the Middle East. For those that chose the latter cooperatives help ease settlement in the Middle East.<sup>82</sup> Thus, the ultimate objectives of the cooperative movement in Israel even before 1948, was non-economic and non-social, but rather a political objective of creating a Jewish state in the Middle East.<sup>83</sup>

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<sup>79</sup>Bonner (n 16) (emphasis added)

<sup>80</sup> Merrett (n 3) 27

<sup>81</sup> Ibid 28

<sup>82</sup> Digby, (n 51) 34

<sup>83</sup>Yehuda Don, ‘Adaptation of Cooperatives to Economic Changes: The Israeli Experience’ (1967) 49(1) Journal of Farm Economics,121

“Cooperation as an essential aspect of social integration appears widespread in peasant communities of East Asia, Indonesia, and the Philippines.”<sup>84</sup> The development in peasant communities of economic mutual aid institutions has indicated a perpetuation of traditional values and patterns of cooperation.<sup>85</sup> Cooperatives, therefore, have also been intended to facilitate the social cohesion of individual members of a community.<sup>86</sup>

## **B. Movements from above: cadre movement<sup>87</sup>**

Cooperative movements in Africa and communist countries have been movements from above. In Africa, cooperatives have served as a mechanism to intervene in the local culture and economy. The communist countries were using cooperatives as a forum to dismantle the old political landscape and build a communist culture of production and distribution of goods/services. In Ethiopia in 1950s, 1960s and 1990s, cooperatives served as instrument of the state to interfere into the economy, particularly in agriculture. In the 1970s and 1980s the cooperatives were used to help the state to build socialist culture. The following subsections look at this in more detail under the headings of ‘Cultural Transformation and Economic Intervention’.

### **Cultural transformation**

Modern cooperatives emerged in Africa during the colonial era as instruments to implement colonial socio-economic policies.<sup>88</sup> For example, the French colonial government utilized cooperatives as instruments to implement its colonial policy of direct rule.<sup>89</sup> The cooperatives were intended to transform African culture into French culture.<sup>90</sup> The Belgian and Portuguese colonial rulers also pursued the same aim of transforming African culture through cooperatives although in “the Belgian territories, cooperative development was closely linked to the

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<sup>84</sup>William Lebra and Thomas Maretzki, ‘The Community Cooperative in Northern Okinawa’ (1963) 11(3) Economic Development and Cultural Change 225

<sup>85</sup> Ibid

<sup>86</sup> Ibid

<sup>87</sup> This phrase is taken from an Interview with Ato Daniel Legesse, Addis Ababa Saving and Credit Cooperative Union Ltd, General Manager, August 3, 2014. He described Ethiopian cooperative movement as a cadre movement.

<sup>88</sup> Frederick Wanyama, ‘Reinventing the wheel? African cooperatives in liberalized economic environment’(2009)80(3)Annals of Public and Cooperative Economics 365

<sup>89</sup> Ibid

<sup>90</sup> Ibid

paternalistic approach of the [colonial administration, which sought to keep Africans in relative underprivileged and subservient positions.”<sup>91</sup> In Portuguese territories, the ultimate object of cooperatives was to bring change in the culture of indigenous Africans.<sup>92</sup>

In the pre-1991 communist countries, recognized cooperatives were mainly used as instruments to pull out individual production culture and inculcate communist culture of production into the general mass. For example “Stalin saw in cooperatives a school for communism in that through association the peasants and their close cousins, the artisans and handicraftsmen of the villages, might learn to work together rather than individually. He expected that by demonstration the work in association would prove to be more productive than individual enterprise.”<sup>93</sup> As a result the Stalin government was using cooperatives to create collective farms in rural areas.<sup>94</sup> China and other Eastern European communist countries had at least partly adhered to this Stalinist view of collectivization.<sup>95</sup>

### *Ethiopia*

The military regime of Ethiopia also adhered to the Stalinist view of cooperatives. In September 1974, the military brigades came to power through a coup. The new Government declared socialism as its political ideology and affiliated itself with the USSR and Cuba. Four years after the coup, the military government issued a cooperative society law.<sup>96</sup> The cooperative societies were organized as a means to build up socialism<sup>97</sup> and so promoted a form of Stalinist collectivism.

The concern of the government was mainly over agricultural cooperatives. This was to remove the remnants of feudalism and semi capitalism in the country in general; and this was especially true in rural areas. These ultimate objectives were intended to be attained by using cooperatives as a medium to provide goods and services, create collective ownership of the means of

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<sup>91</sup> Ibid 366

<sup>92</sup> Ibid 367

<sup>93</sup> Andrew Griffin and Larry Soderquist, ‘The Soviet Cooperative before Perestroika: The Leninist versus The Stalinist Concept’ (1991) 39(3) The American Journal of Comparative Law 605

<sup>94</sup> Digby (n 51) 70

<sup>95</sup> Ibid 71-80

<sup>96</sup> Hans Hedlund (ed), ‘Cooperative Revisited’ (1988) Seminar Proceedings No. 21 125-127

<sup>97</sup> Michael Stahl, ‘Capturing the Peasants through Cooperatives: The Case of Ethiopia’ (1989) 44 Review of African Political Economy 30-33

production and to mobilize efforts and resources of the broad masses.<sup>98</sup> Cooperative societies were expected to become involved in political agitation to effect the transformation of feudal culture into socialist culture and the building of a socialist economy. They were intended to serve as a bridge to access the scattered peasantry.

Traditionally and with aspects still true in the contemporary society, the Ethiopian peasantry lived in scattered homesteads in between fields and pastures where small clusters of houses can be found.<sup>99</sup> Such a situation, combined with an absence of a communication infrastructure, made the peasantry inaccessible for socialist collective ownership and planned economy. To solve the problem, in 1975 the Government established Peasant Associations all over the country within a minimum area of 800 hectares.<sup>100</sup> Every resident of the locality was by default a member. The purpose of the Association was to distribute expropriated land to its members thereby leading to the defeat of landlords and the abolition of the feudal system. In the same year, the Government established the Agricultural Service Association within areas of every Peasant Association to provide agricultural inputs and consumption goods to members of the Peasant Association and to purchase agricultural products from members on behalf of Government.<sup>101</sup> These associations were under a duty to politically indoctrinate the peasantry and then encourage collective or communal farming.<sup>102</sup> However, communal farming did not emerge as expected and some small farmers began to thrive.<sup>103</sup> This was taken by the Government as a symptom of re-emergence of capitalism or at least the retardation of the socialist revolution.<sup>104</sup> Hence the Government decided to apply another alternative, the agricultural producer cooperatives, that would make the peasantry more accessible to political policies and to discourage small holders.<sup>105</sup>

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<sup>98</sup>Ibid

<sup>99</sup> Ibid 30

<sup>100</sup> Hedlund (n 96) 125-127

<sup>101</sup> Stahl (n 97) 29

<sup>102</sup> Desalegn Rahmeto, 'Agrarian Change and Agrarian Crisis: State and Peasantry in Post-Revolution Ethiopia' (1993) 63(1) *Journal of the International African Institute* 39

<sup>103</sup> Stahl (n 97) 29

<sup>104</sup> Ibid

<sup>105</sup> Ibid

## Economic intervention

Cooperatives have been used as instrument by the state to interfere in the economy mainly in Africa and South East Asia.<sup>106</sup> In Africa, such a strategy was started by the colonial powers but further strengthened after independence. Since the 1960s, Ethiopia employed cooperatives as an instrument to interfere in the agricultural sector of the economy.

### *Post-independence Africa*

As already indicated, cooperative development in Africa originated from individual state's political objectives.<sup>107</sup> In addition to the objectives of transforming African Culture, they were intended to serve as way for the state to interfere in the economy. Although the economic agenda existed before independence, it was further strengthened after independence. For example, the British promoted cooperatives to increase the productivity of white settler cash crop farmers in order to enhance export to Britain; the cash crops being integral to fuel industrialization in Britain.<sup>108</sup>

This tradition was continued after independence. "In the independence era of the 1960s, cooperatives were widely seen as central instruments for development, which could be promoted rapidly on a large scale."<sup>109</sup> In many African countries, cooperatives were the African alternative to Asian or European private trade.<sup>110</sup> For example, in Egypt, cooperatives served the political mission of land distribution and joint planning of agriculture.<sup>111</sup> In Kenya also, in order to maintain the quality of coffee, coffee farmers have been required to belong to cooperatives.<sup>112</sup> In Kenya, a more systematic promotion of cooperatives was begun in the 1950s with the motive of encouraging commercialization of smallholder agriculture.<sup>113</sup> This was because cooperatives were expected to ease land dispute adjudication, improve rural infrastructure, introduce cash

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<sup>106</sup> For example Indonesian government has been encouraging coops to build the country's economy. See Williams (n 58) 87

<sup>107</sup> Wanyama (n 88) 365

<sup>108</sup> Ibid

<sup>109</sup> Des Gasper, 'Review: Reassessing Cooperatives in Africa' (1990) 25(13) Economic and Political Weekly 669

<sup>110</sup> Ibid

<sup>111</sup> Digby (n 51) 24

<sup>112</sup> Spaul (n 15) 97

<sup>113</sup> Hedlund (n 96) 43

crops, and provide easy marketing for the cash crops.<sup>114</sup> In Tanzania, the Government intended to use cooperatives as a means of economic independence from control by non-African expatriates.<sup>115</sup> Foreign aid agencies have also been sponsoring a state-led cooperative movement.<sup>116</sup>

### *Ethiopia*

Ethiopia introduced the cooperative concept in 1960s to indirectly intervene into the agricultural sector of the economy. In the 1960s, there were two pieces of legislation showing two sub phases of development. The first was the Imperial decree of 1960 which authorized the Government to organize farm cooperatives, and the second was the 1966 proclamation which recognized citizens' right to operate collectively in order to solve their economic problems.

The ultimate aim of the Farm Workers' cooperative was to bolster the agricultural production of the country.<sup>117</sup> The Government believed that cooperatives would be a good alternative to reduce the cost of production through economies of scale.<sup>118</sup> Additionally the cooperative was also thought to serve as a forum to promote modern farming, in which the cooperative could demonstrate to farmers the benefit of modern agricultural technology.<sup>119</sup> Cooperatives were also claimed to serve as a means to pull economic resources together – although paradoxically all the financial resources were to be obtained from the government and members were not required to contribute anything at all.<sup>120</sup>

The formation of the Farm Worker Cooperative involved five steps. The first step was that the government designated the land available for transfer to the cooperative to be formed.<sup>121</sup> This might have implied that the next step would not be taken unless the Government was sure about the existence of land to be transferred. The second step was registering individuals who were willing to be farm workers in a cooperative. Although it was the responsibility of individuals to personally appear and register, it was self-evident that the Ministry of National Community

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<sup>114</sup> Ibid

<sup>115</sup> Ibid

<sup>116</sup> Wanyama (n 88) 371

<sup>117</sup> See the preamble of Farm Workers' Cooperative Decree No.44/1960

<sup>118</sup> Ibid Art 3(a)

<sup>119</sup> Ibid Art 3(c)

<sup>120</sup> Ibid Art 3(e), 6, 14, 19 and 37

<sup>121</sup> Ibid Art 4



Development had to promote cooperatives and push individuals to apply for membership.<sup>122</sup> The third step was the formation of the cooperative group.<sup>123</sup> The Ministry of National Community Development was empowered to form a syndicate among the applicants registered.<sup>124</sup> The fourth step was electing members of the executive committee and members of supervisory board including the appointment of a General Manager by the Ministry of National Community Development.<sup>125</sup> The fifth step was giving juridical personality to the syndicate as a cooperative.<sup>126</sup>

It was the Ministry of National Community Development which took direct responsibility for organizing the cooperative. The role of the member was simply to appear and register and participate in the organizing meeting.<sup>127</sup> Moreover, the Government used to transfer state owned land into the “rist”<sup>128</sup> holding of members of the cooperative.<sup>129</sup> The members were required to contribute nothing to the initial capital. The State provided for all necessary expenses to begin the agricultural activity.<sup>130</sup> And, although this was provided in the form of a loan, it was on favorable terms with low collateral requirements, low interest rates and convenient repayment alternatives.<sup>131</sup> Furthermore, the cooperative was entitled to technical advice and assistance in the fields of agronomy, animal husbandry, marketing and related fields, free of charge.<sup>132</sup>

Every member was to be issued an equal share, and if they did not want to supply their labour to the cooperative they would lose their entitlement to be a member.<sup>133</sup> Furthermore, even after joining the cooperative a member could be expelled if they refused to work on a common farm of the cooperative for a minimum of two hundred days in a year.<sup>134</sup> Moreover, although a member could sell his shares, he had to sell to a non-member employee of the cooperative if the employee desired to buy.

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<sup>122</sup> Ibid Art 5 cum Art 2

<sup>123</sup> Ibid

<sup>124</sup> Ibid

<sup>125</sup> Ibid Art 9 and Art 33-35

<sup>126</sup> Ibid Art 10

<sup>127</sup> Ibid Art 5-10

<sup>128</sup> The word ‘rist’ an Amharic word and does not have equivalent English translation but it represent a landholding that can be transferred only to a blood relative and not subject to market forces.

<sup>129</sup> Farm Workers’ Cooperative Decree No.44/1960, Art 11

<sup>130</sup> Ibid Art 37

<sup>131</sup> Ibid

<sup>132</sup> Ibid Art 38

<sup>133</sup> Ibid Art 6(c) cum. 17(c)

<sup>134</sup> Ibid Art 19(d)

A member could not own more than, or less than, one share except by inheritance.<sup>135</sup> Every member has only one, or less than one vote which has to be cast only in person<sup>136</sup>. These restrictions generally blocked the intrusion of capitalists seeking to buy into the cooperatives and ensured that they would not be able to benefit from the privileges intended for landless poor.

The consent of the Ministry of National Community Development was necessary to sell machineries and equipment, the cooperatives were bound to accept a General Manager appointed by the Ministry to only borrow money from the Ministry, and accept the power of veto of the Ministry.<sup>137</sup>

The proclamation No.241/1966 was the second and last phase of cooperative development in the 1960s. The ultimate aims of the cooperatives were attaining social justice and the improvement of members' income. Cooperative societies were expected to attain the latter objective by reducing the cost of production and consumption through economies of scale, by pooling capital, by sharing risks and sharing technological knowledge.<sup>138</sup> After the initiators agreed on the rules or bylaws of the cooperative, they had to submit an application for registration to the Registrar of Cooperatives in the Ministry of National Community Development & Social Affairs.<sup>139</sup> The cooperative would get legal personality upon registration.

The benefits that cooperative societies could receive from the government were the allotment of government land and financial assistance (either in the form of loan, subsidies, ad hoc grants, standing as a guarantor to third parties for the payment of share capital or dividend).<sup>140</sup>

The property of the society was distinct from the individual capital holders and could be distributed to members only upon dissolution.<sup>141</sup> Cooperative societies were not entitled to invest their money in a manner that would prejudice their ultimate purposes.<sup>142</sup> Accordingly, cooperative societies could not establish an investor owned firm or even purchase shares in such type of firm. Only ten percent of profit could be distributed as dividend.

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<sup>135</sup> Ibid Art 17(a &b)

<sup>136</sup> Ibid Art 18(a)(iii)

<sup>137</sup> Ibid Art 29(b),35,39,45

<sup>138</sup> Cooperative Societies Proclamation No. 241/1966, Art 4

<sup>139</sup> Ibid Art 9

<sup>140</sup> Ibid Art 32(2)

<sup>141</sup> Ibid Art 33 cum 77(1)(d)

<sup>142</sup> Ibid Art 35

The sole purpose of the Registrar, (to be appointed by the Emperor and accountable to the Minister of the Ministry of National Community Development & Social Affairs), was supervision and control of cooperative societies so that they would attain the objective for which they were recognized for by the Government.<sup>143</sup> The Registrar would refuse to register cooperative societies which did not recognize the purposes of cooperatives societies listed under Art 4 of the proclamation.<sup>144</sup> The Registrar was required to supervise the daily activities of the society and if the society was found to have acted contrary to purpose of the cooperative, the Registrar had the power to remove the Executive Committee of the society.<sup>145</sup> The Registrar could audit the account of the society and make any necessary inquiry to ensure that the relevant law was adhered to by the society.<sup>146</sup>

The military government also had an intention to use cooperatives to interfere in the economy. The economic reasons for the government's interest with agricultural cooperatives were the potential economies of scale, technology transfer and land fragmentation.<sup>147</sup> It was believed that if peasants were organized they would more easily access the Government's technical and financial support. Moreover, they were expected to serve as a model for other peasants so that the backward plough farm would be transformed into mechanized farming.<sup>148</sup> Furthermore, it was argued that smallholdings were less desirable than large scale farming and so land had to be consolidated by forming producer cooperatives.<sup>149</sup>

### **C. Movement from the side: philanthropist's movement**

Cooperative movements from the side have been manifest in Asia where cooperatives have been mainly used by philanthropists' as an economic strategy to reduce poverty and to fight caste system.

As stated above, the engine of the cooperative movement could be either the members themselves or the political state. Since the nature of the engine determines the purpose of

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<sup>143</sup> Ibid Art 27

<sup>144</sup> Ibid Art 9 cum. 10

<sup>145</sup> Ibid Art 27

<sup>146</sup> Ibid Art 38 & 39

<sup>147</sup> Stahl (n 97) 30-33

<sup>148</sup> Ibid

<sup>149</sup> Ibid

cooperatives, cooperative movements from below have had the objectives of either economic or social self-defense, whereas the cooperative movement from above had the objective of cultural or economic transformation with a political end-goal. There is a third engine of the cooperative movement- which this paper terms movement from the side simply because it is a movement by citizens to help other citizens: with an objective of charity. Although charity cooperative movements began in Britain to tackle the dangers of economic competition, it currently manifests itself in South East Asia to tackle poverty and the caste system.

### **Ending human misery**

The first charitable cooperative movement was Robert Owen's village of cooperatives.<sup>150</sup> His ultimate purpose was to abolish competition, which, he thought, was the source of human misery. He believed that both the life of capitalists, the employees and society as a whole was made miserable due to fierce and merciless competition. According to him, competition-led human beings learn strong powers of deception and selfishness.<sup>151</sup> The competitive system enslaved not only workers but also the factory owners themselves.<sup>152</sup> Equally he believed that if workers were happier, healthier and received better character moulding education they would be more productive.<sup>153</sup> He also believed that crime, misery and poverty were, due to bad character of human beings shaped by competition.<sup>154</sup>

To end such human misery he established a village of cooperatives with the ultimate aim of building the New Moral World that would be free of competition, full of cooperation and organized his workers in a community consisting of about a thousand persons occupying one thousand five hundred acres of land.<sup>155</sup> He greatly improved the life of the workers by providing quality food and drinks in the factory shop and social facilities such as children's education, contributory sickness benefit scheme and a savings bank.<sup>156</sup> He introduced humanitarian practices to encourage more discipline among the labour force and he prohibited corporal

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<sup>150</sup>Peter Davis and Martin Parker, 'Cooperatives, Labor, and the State: The English Labor Economists Revisited' (2011) *Review of Radical Political Economics* 522

<sup>151</sup> Bonner (n 16) 11

<sup>152</sup> Ibid 5

<sup>153</sup> Thornely (n 17) 12

<sup>154</sup> Bonner (n 16) 14

<sup>155</sup> Bonner (n 16) 14

<sup>156</sup> Ibid

punishment.<sup>157</sup> He also reduced the working hour to 10½ hour per day, abolished summary dismissal (except for drunkenness) and allowed the workers to appeal against any disciplinary decision.<sup>158</sup>

### **Poverty eradication**

It is believed that access to loans would contribute a lot for poverty reduction. However, the poor could not usually have a chance to access loans from financial institutions, since banks usually do not extend loan to the poor, either because the poor never provide enough collateral or due to cost-inefficiency of the administration of a large amount of small loans. Thus, the poor would normally perpetually remain in a poverty trap.

Muhammad Yunus, an economist and a philanthropist, realized this vicious circle of the poverty trap and developed the principles of a sustainable credit program for the poor.<sup>159</sup> He started the Grameen Bank of Bangladesh in 1976 which make capital available to very poor rural women who form small groups of borrowers from the same community.<sup>160</sup> The group serves as a collective source of collateral to compensate for individuals' lack of financial collateral.<sup>161</sup> "Professor Yunus applies the Rochdale Cooperative Principles in setting up his micro-credit system."<sup>162</sup> The group is a true cooperative sustained by interest and saving deposits from its owners.<sup>163</sup> This micro-credit scheme has enabled millions to break the poverty trap.<sup>164</sup>

### **Caste eradication**

In India, NGOs have started to use the cooperative model to fight the caste system.<sup>165</sup> Although the Indian Constitution makes the caste system illegal, it remains the character of modern Indian society.<sup>166</sup> As a result, the lower caste communities have been

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<sup>157</sup> Ibid

<sup>158</sup> Ibid

<sup>159</sup> Williams (n 58) 84

<sup>160</sup> Denise Anthony, 'Cooperation in Microcredit Borrowing Groups: Identity, Sanctions, and Reciprocity in the Production of Collective Goods' (2005) 70(3) American Sociological Review 500

<sup>161</sup> Ibid

<sup>162</sup> Williams (n 58) 85

<sup>163</sup> Ibid

<sup>164</sup> Joseph Stiglitz *The Price of Inequality* (Penguin, 2013) 246

<sup>165</sup> Williams (n 58) 100

<sup>166</sup> Ibid

systematically excluded from all economic, political and social processes and institutions of the society.<sup>167</sup> For example, the banking community has already stereotyped the lower castes as chronic loan defaulters.<sup>168</sup> The lower castes have had no alternatives except to build their own institutions.<sup>169</sup> Consequently, some lower cast NGOs began small programmes of women's thrift and credit on the Grameen model.<sup>170</sup> The success of these thrifts has implicated that the cooperative model movement would liberate the lower cast from the tyranny of the political and economic power of a small and corrupt elite class.<sup>171</sup>

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<sup>167</sup> Ibid

<sup>168</sup> Ibid

<sup>169</sup> Ibid

<sup>170</sup> Ibid

<sup>171</sup> Ibid

## 1.2 Cooperatives losing their path

In this sub-topic we do two things; first; we indicate the movement of cooperatives into the course of profiteering by showing the structural adjustment and modifications of cooperative principles. Second, we attempt to examine the factors that have pushed cooperatives into such a course.

### A. Cooperatives moving onto a profiteering path

The cooperative movement has been declining since the beginning of twentieth century.<sup>172</sup> They lost market share in the twentieth century.<sup>173</sup> Although indicators of the decline began to show at the beginning of the century,<sup>174</sup> it became very clear after World War II.<sup>175</sup> After the 1970s, researchers also began to indicate that cooperatives have been unable to attain the objectives they intended.<sup>176</sup> In Britain, the origin of modern cooperatives had by the 1990s seen cooperative stores shut down.<sup>177</sup> Between 1995 and 2000 alone Britain lost 20 percent of its local economic outlets which were mostly cooperatives.<sup>178</sup>

Such a dramatic decline in the market share of cooperatives gradually pushed forward a radical reformulation of the overall strategy of the cooperative movement.<sup>179</sup> In Western economies, many cooperatives have undergone profound changes.<sup>180</sup> For example, some cooperatives partly or wholly exchanged collective ownership with individual ownership by investor owned firms Others have disappeared due to mergers or acquisitions.<sup>181</sup> A number of bankruptcies have

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<sup>172</sup>John Walton, 'Commemorating the Co-op: Nostalgia, Identity and the Visual Traces of the Cooperative Movement in Twentieth-Century Britain' (2008) 24(2) *Visual Resources* 159-172

<sup>173</sup>Lawrence Black and Nicole Robertson (eds), *Consumerism and the Cooperative Movement in Modern British History* (Manchester University Press, 2009) 2

<sup>174</sup>Sidney Webb and Beatrice Webb, *The Consumers' Cooperative Movement* (Longmans, 1921) 235

<sup>175</sup>Black (n 173) 1

<sup>176</sup>Wanyama (n 88) 370

<sup>177</sup>Black (n 173) 13

<sup>178</sup>Ibid 14

<sup>179</sup>Ibid 55

<sup>180</sup>Jerker Nilsson, Gunner Svendsen and Gert Svendsen, 'Are large and complex agricultural Cooperatives losing their Social Capital?' (2012) 28(2) *Agribusiness* 187

<sup>181</sup>Ibid

occurred.<sup>182</sup> Some cooperatives have sold a part of their business activities to investors, thus creating a hybrid-type cooperative.<sup>183</sup> Still others have converted into investor-owned firms.<sup>184</sup>

.There also emerged a new generation cooperative movement especially in agricultural cooperatives.<sup>185</sup> In the new cooperative movement members were profit-driven.<sup>186</sup> To attain this objective, membership is limited<sup>187</sup>. This means the optimal operating capacity of the firm typically drives membership numbers. The cooperatives accept membership up until the profit margin reaches its maximum turning point. In true cooperatives membership is open to every body who could use and willing to use the service of the cooperative. Moreover; members is also closed.<sup>188</sup> Membership becomes the result of freedom of contract. No one is entitled to join unless the existing members agree to accept him even in case the optimal operating capacity is not yet reached. Moreover, capital is an essential requirement for membership.<sup>189</sup> There are also stringent supply contracts that require every member to sell specified quantities of goods/service to the cooperative.<sup>190</sup>

This has further led to the varied interpretation and adoption of cooperative principles. Some principles, such as open membership, mutuality principle (use of cooperative service as a criterion to share profit) and democratic control have been fading from cooperatives and a few new principles, (such as up-front investment of capital than gradual accumulation, profit on the basis of capital investment, membership open for investors) have been added. In short, cooperatives have continued to evolve and to reflect changes in society, agriculture and more directly the interest of its members.<sup>191</sup>

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<sup>182</sup> Ibid

<sup>183</sup> Ibid

<sup>184</sup> Ibid

<sup>185</sup> Merrett (n 3) 47-48

<sup>186</sup> Ibid 64

<sup>187</sup> ibid

<sup>188</sup> Ibid

<sup>189</sup> Ibid

<sup>190</sup> Ibid

<sup>191</sup> Ibid 52



## **B. Factors pushing cooperatives onto a profiteering path**

The major factors that have caused cooperatives to divert their route towards profiteering are the changing role of the state, the emergence of efficient company owned hypermarkets, and consumer associations and also globalization. These are the external factors. They also have internal problems such as unmanageable sizes, disloyalty of members, clique, declining in cooperative education and a scarcity of capital.

### **External Challenges**

As stated above the external factors are changing role of the state, the emergence of efficient company owned hypermarkets, consumerism and consumer associations, and globalization. Here below we briefly examine how they have affected cooperatives.

#### *Changing Role of the State*

Emergence of cooperatives in the nineteenth century in Europe and North America was to respond to market inefficiency inherent in capitalism burdened by a state unwillingness to seek redress.<sup>192</sup> The main reason why the state did not respond to such problems was due to a political-economic ideology of the time- laissez fair. This ideology preaches that the state should never interfere with economic activities and suggests that the market itself should find a solution to the problems of the economy. However, since competition of the time was not able to solve the problem; the only market solution of the time was cooperation between producers, consumers or workers in the form of a cooperative movement.

However, this laissez fair ideology lost practical support after the First World War. States began to interfere in the economy either indirectly as regulator or directly as an investor. Protective labour legislation begun to be issued to improve the life of the working class and in some cases the state has become a major employer. Anti-trust laws have also been issued to fight market monopolies. Welfare systems have also been introduced in Western economies. Consumer protection laws have also emerged. State enforced standardization of quality of goods and services have also been the characteristics of the contemporary economy. This commitment of

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<sup>192</sup> See our discussion supra in section 1:1

the State to address the defects of market economy has forced cooperatives to justify themselves only on the basis of economic efficiency. In short state interference into the economy has taken away the not-for-profit objectives of cooperatives.<sup>193</sup>

#### *Emergence of efficient company owned hypermarkets*

However, the reemergence of the laissez fair ideology in the 1970s proved cooperatives economically inefficient unless reorganized along neoliberal lines.<sup>194</sup> Laissez faire is more favorable to the private sector. As a result, bigger and better integrated companies appeared to challenge the market stature of cooperatives almost in all sectors of the economy.<sup>195</sup> The private sector has begun to challenge cooperatives by the beginning of the twentieth century.<sup>196</sup> But after the 1970s, “instead of monolithic corporation, many firms have reinvented themselves as networks of holdings, joint ventures, subsidiaries, contracts and outsourced services Globalization has also facilitated this trend of companies because it allowed for free movement of capital without borders. In addition to the issue of inefficiency compared with their competitors, cooperatives entered into heavy loans while they were attempting to expand their business with the intention of remaining competitive.”<sup>197</sup>

#### *Consumer culture and consumer associations*

It has been asserted that the decline of consumer cooperatives is directly related to the emergence of neoliberalism (capitalism).<sup>198</sup> Capitalism is capable of creating a consumer culture on the basis of individual test influenced by advertisement than on the basis of collective solidarity or prudence.<sup>199</sup> As a result, individuals do not usually have a sentiment to consume similar things and hence they prefer to purchase from multiple companies than cooperatives which usually provide goods on the basis of collective sentiment. This diverse sentiment is better protected through consumer associations that advocate for the rights of consumers than consumer cooperatives that provide goods and services. As a result, the consumer associations movement emerged and the state has also consolidated the movement by issuing consumer protection laws.

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<sup>193</sup>Bonner (n 16) 156

<sup>194</sup>See our discussion of theory of firm in Chapter Two.

<sup>195</sup>Merrett (n 3) 46

<sup>196</sup>Bonner (n 16) 156

<sup>197</sup>Black (n 173) 54

<sup>198</sup>Merrett (n 3) 267

<sup>199</sup> Ibid 48

## **Internal challenges**

Major internal challenges have been an unmanageable size, disloyalty of members, emergence of cliques and the decline of cooperative education and scarcity of capital.

### *Unmanageable size*

One of the features of the cooperative movement after WWII was the consolidation of cooperatives through amalgamation and merger.<sup>200</sup> This made cooperatives larger in size but fewer in number. This larger size posed the problem of the heterogeneity of interests of members, and the need for a sophisticated management. Heterogeneity of interest fueled by the consumer movement challenges the ability of the cooperative to satisfy members' sentimental test of goods/services. Moreover, large size demands a sophisticated management. As the management gets more sophisticated it becomes more autocratic than democratic. Autocratic management is less transparent. Such a lack of transparency would make members lose trust in the cooperative. Researchers have shown that member's trust in cooperatives and in each other has been declining.<sup>201</sup>

In addition to the large number of members, the size of the business could also be unmanageable. If a consumer cooperative attempts to supply everything the members may buy, or producer cooperative attempts to sell everything the member may sell, or worker cooperatives have members with varied and unrelated skills, surely the cooperative will fail. Investor owned firms do normally specialize in certain areas of consumer demand.

### *Disloyalty of members*

The heterogeneity of interests, the increase of consumerism and the distrust of management, might have eroded the loyalty of members to the cooperative. Research indicates that one of the challenges to cooperatives has been lack of loyalty of members to their cooperative.<sup>202</sup> Members avoid transactions with the cooperative or remain passive in the cooperative activities and do not participate in the decision making process of the cooperative.<sup>203</sup>

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<sup>200</sup> Ibid 41

<sup>201</sup> Nilsson (n 179)

<sup>202</sup> Williams (n 58) 151

<sup>203</sup> Ibid

### *Emergence of cliques*

Another challenge for cooperatives has been the emergence of interest groups within them.<sup>204</sup> This problem is an extension of the problem of autocratic and opaque management, and passivity of membership. This problem is especially rampant in Africa where there is patrimonial political economy.

### *Declining of cooperative education*

Cooperative education is essential to disseminate cooperative ideas and attract new members and public support. But researchers show that cooperatives have not been able to educate their members in particular and the public in general.<sup>205</sup>

### *Scarcity of capital*

It is usual that cooperatives face capital scarcity since their members are not investors who have unutilized capital. This problem usually forces cooperatives to invite investors to be members. They may also be forced to compromise their autonomy by receiving funds from donors or state agencies.

## **1:3 Conclusions**

Thus this Chapter shows that cooperative objectives have been transforming from not-for-profit objectives to for-profit objectives.

In the past although there have been multiple cooperative objectives due to multiple engine of the cooperative movement, all those objectives were however; not-for-profit objectives. The first engine of movement has been from individuals. Economic self-help movements have been the major types of cooperatives especially in North America, Britain and Continental Europe and their ultimate objectives were to protect the small hold producers, consumers and workers from the ill effects of market economy. Individuals have also created cooperative ‘like’ associations and cooperatives to nurture ethical value and to ensure collective security. In this regard the collective life of early Christians, the associations of European Settlers in North America and the peasant cooperatives in South East Asia are worth mentioning. The second engine has been

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<sup>204</sup> Ibid

<sup>205</sup> Ibid

Governments. Cooperatives have served colonial and post colonial governments of Africa to transform the culture of the local community. Communist governments including the military government of Ethiopia used cooperatives as forum to indoctrinate communism to the rural community. Colonial and post colonial governments of Africa including the imperial government of Ethiopia have also used cooperatives as a spring board to intervene into the economy of the continent. The third source of cooperative movement has been the philanthropists who have decided to fight human misery, poverty and caste system. Robert Owen's cooperative village, Mohammed Yunus' Grameen Bank of Bangladesh, and lower cast communities' NGOs in India have been typical examples.

However; in recent times cooperatives have been adopting many of the characteristics of investor owned firms that pull them away from not-for-profit objectives but push them into for-profit objectives. This have been due to the widening of state responsibility to include individual's economic challenges, emergence of efficient company owned hypermarkets, change of consumer culture that led to emergence of consumer associations. These factors have taken off the ultimate objectives for which cooperative have been established in earlier times. Major internal challenges such as unmanageable size, disloyalty of members, emergence of cliques, and decline of cooperative education and scarcity of capital have been additional factors that have pushed cooperatives into profit-seeking objectives. Thus cooperatives have become uncategorizable in terms of their identity when one attempts to distinguish them from investor-owned firms.

In this chapter we have seen the move of cooperators into the idea of investor owned firms. In the next chapter we analyze the move of investors into the idea of cooperatives.

## CHAPTER TWO

### COOPERATIVE AS AN INVESTOR-OWNED FIRM

#### 2.0 Introduction

Ownership of a firm has two essential attributes.<sup>1</sup> These attributes are exercise of control and the receipt of residual earning.<sup>2</sup> The exercise of control “is the authority to determine those aspects of firm policy that, because of high transaction costs or imperfect foresight, cannot be specified ex ante in a contract but rather must be left to the discretion of those to whom the authority is granted.”<sup>3</sup> The residual earning indicates both the profit and the residual asset after liquidation.

The ultimate objective of this topic is to show that there is a possibility for profit-seekers to organize their business in the form of cooperative thereby blurring the distinction between the cooperative form of economic organization and the company form of economic organization. Thus it is argued that cooperatives may be the result of economic rationality of assigning ownership within the ambit of freedom of association. This is because the cooperative form of economic organization could possibly be a firm and a firm is the result of economic rationality. Furthermore; the structure of ownership in a firm (cooperative ownership/company ownership) may be solely the result of economic choice. Still more the structure of ownership in a firm does not necessarily guarantee or hinder public purposes/profit-maximizing purpose: what really matters is the accountability of the management. This means, depending on the accountability of the management, there is a possibility that cooperatives may be utilized to maximize profits whereas companies may be utilized to protect the public interest. In short depending on the freedom of association<sup>4</sup> and the freedom of contract,<sup>5</sup> the cooperative form of organization could be utilized for profit-maximizing purpose.

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<sup>1</sup> Martin Ricketts(ed), *The Economics of Modern Business Enterprise Volume II: Ownership and Scope* (2008) The International Library of Critical Writings in Economics series 43

<sup>2</sup>Ibid

<sup>3</sup> Ibid 20

<sup>4</sup>Every person has the right to freedom of association for any cause or purpose. See Art 31 of the FDRE constitution.

<sup>5</sup>Freedom of contract enables members to determine the type of transactional relation that they may have with their firm.

To this effect the first subtopic shows that (A) firm is born out of nexus of contract to carry out economic activities; (B) the cooperative form of economic organization could be born out of nexus of contract ;(C ) individuals enter into nexus of contract out of economic rationality. The second subtopic shows that cooperative form of firm ownership (types of nexus of contract) could also be the result of economic rationality of parties to the contract. As a continuation of this economic rationality, the third subtopic intends to indicate that cooperative form of the firm ownership may be preferred depending on the extent of freedom of contract in determining the content of nexus of contract guaranteed by the law to cooperative form and other forms of economic organization (partnership/company).

## **2.1 The firm and theory of the firm<sup>6</sup>**

Here we discuss three interrelated points. The first point is to attempt to define a firm. A firm is a fictitious legal person that is born out of a nexus of contracts to carry out economic activities. The second point is to show that cooperatives are economic alternatives to investor-owned firms since all firms, including cooperatives, are owned by individuals that have transactional relation within the firm. The third point is show that firms are the result of economic rationality.

### **A. The firm as nexus of contract**

A firm is a legal person coming out of a cooperative production agreement. According to economists, a firm is the result of nexus of contracts. In other words, a firm is a point at which multiple contracts such as contract of supply of raw materials, employment contracts, loan contract and purchase contracts are connected to each other.<sup>7</sup> Since a firm is contract that connects many contracts together, it has special features that distinguish it from ordinary contract. The two main features of the firm are the informal non-specific nature of the contracts and the consequent necessity for enforcing such contracts internally by the exercise of authority by some of the parties to the contract themselves.<sup>8</sup> The law gives legal personality to the firm so that none of those who enter into each particular contract that form the firm would not be unnecessarily burdened with market risks.

### **B. Cooperatives and investor-owned firms**

The word ‘firm,’ can refer to cooperatives and investor-owned firms. Much of their difference is in how they are owned. For example, producer cooperatives are owned by their suppliers. The cooperative pays the member owners a predetermined price for the product they supply. This price is set low enough so that the cooperative is almost certain to get positive net earnings from the resale of the goods with or without adding value to it. At the end of the financial year the cooperative’s net earnings are divided pro rata among the members according to the amount of goods they supplied to the cooperative during the year. All the voting rights are also apportioned among its producer members either according to the goods they supplied or more simply on a

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<sup>6</sup> Unless expressly or impliedly indicated the ideas in this subtopic are adapted from Ricketts (n 1) 11-49

<sup>7</sup> Ricketts (n 1) 26

<sup>8</sup> Dennis Muller, *The Modern Corporation: Profit, Power, Growth and Performance* (Wheat Sheaf Books Ltd, 1986) 66 (emphasis partly added)



one-member one-vote basis. Some or all of the members may have capital invested in the firm. In principle, however, this is unnecessary as the firm might borrow all the capital it needs. In any case even when the members invest in the firm, those investments generally take the form of debt or preferred stock that carries no voting rights and is limited to a stated maximum rate of dividends. Upon liquidation of the cooperative, any net asset's value which may be derived from retained earnings or from increase in the value of asset owned by the cooperative is divided pro rata among the members, according to some measure of the relative value of their cumulative supply. The cooperative may purchase some portion of the supply of goods from non-members, who are simply paid a fixed price (which may be different from the price paid to members) and do not participate in net earnings or control.

The structures of consumer cooperatives and worker cooperatives are similar to producer cooperatives except on the criteria of apportioning net earnings and votes. In consumer cooperatives, net earnings and votes are apportioned according to the amounts that members purchase from the cooperatives. In worker cooperatives, the net earnings and votes are assigned in proportion to the value of labour that a member supplied to the cooperative. In consumer cooperatives, members are clients of the cooperatives. In worker cooperatives the members are employees of the cooperative.

Similarly in investor owned-firms, the members are lenders of the firm. Each member lends it a given sum of money, which the investor-owned firm uses to purchase the equipment and other assets it needs to operate. It pays the members a fixed interest rate on their loans, set low enough so that there is a reasonable likelihood that the investor-owned firm will have net earnings after paying this interest and all other expenses. Its net earnings are then distributed pro rata among its members according to the amount they have lent, with distribution taking place currently, as dividends, or upon liquidation. Similarly, voting rights are apportioned among members in proportion to the amount they have lent it. To supplement the capital that it obtains from its members the investor-owned firm may borrow money from lenders who are not members, but who simply receive a fixed rate of interest (which may be different from the fixed rate paid to members) without sharing in residual earnings or control. In short, supplying capital is one form

of transactional relationship to which ownership is tied. Investor-owned firms are, in this way, lender cooperatives or capital cooperatives.

Three major objections may be raised against this conclusion. The first objection is that, in investor-owned firms, the loan from members is usually perpetual; members can withdraw their capital only upon dissolution of the investor-owned firm while members of cooperatives are free to vary the volume of their transactions with the cooperatives overtime and even to terminate membership altogether. However, this objection is untenable since the individual members of investor-owned firms are also free to sell part or the whole of his or her interest in the investor-owned firms to another person at any time. More importantly, investor-owned firms sometimes permit members to redeem their invested capital at specified interval or even at will. Conversely cooperatives often require their members make a long term commitment to remain member.

The second area of objection concerns the assignment of voting rights. In investor-owned firms the general rule is one-share, one-vote; votes are apportioned according to the amount of capital contributed to the investor-owned firm. In contrast, in many cooperatives the rule is one-member, one-vote with no adjustment to the amount of transactional relationship between the member and the cooperative. However, the difference is neither universal nor fundamental. The charter of many eighteenth and nineteenth century American investor-owned firms limited the number of votes an individual shareholder could exercise regardless of the number of shares he/she owned.<sup>9</sup> Only in the twentieth century, did the practice of one-share, one-vote become nearly universal. There are also many cooperatives that allocate voting rights proportionate to the volume of transactions the member has had with the cooperatives.<sup>10</sup>

The third area of objection is the claim that ownership is necessarily connected to capital in the sense that the owners of a firm, whether they are suppliers or customers or workers or whatever,

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<sup>9</sup>Under Ethiopian Commercial code also partnerships in principle follow one member-one vote principle unless the contrary is expressly provided in the memorandum of association of articles of association. Moreover; in a Private Limited Company the law intends to combine one member- one vote and one share- one vote principles and in case the combination is not possible it gives the principle of one member-one vote precedence over the principle of one share- one vote. In a Share Company also although the principle is one share-one vote, the law reminds members their freedom to limit such voting rights. See Commercial Code Art 234, 407, 408 and 535

<sup>10</sup> See also Christopher and Walzer, Norman (eds.) *Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century* 2004 59-60

are the persons who effectively own the firm's capital, such as its plant and equipment. But this is not necessarily true. The firm could rent rather than own the land, buildings, and equipment it uses. It could, in fact, have title to no physical assets whatever and yet still be a large and prosperous firm. It could even have no net financial assets, distributing all profits to members as they are earned and maintaining a line of credit at a bank sufficient to ensure that it can pay bills in periods when expenses temporarily exceed receipts.

### **C. Theory of the firm**

Theory of the firm indicates that a firm is the result of economic rationality. A firm could resolve the problem of costliness, uncertainty, inflexibility, free riding, unenforceability problems that encircles other form of economic cooperation such as market, face to face relation and individual contracts.

Economic rationality is concerned with choice. There is always a scarcity of resource. Paradoxically human desires are always infinite. The desires are both material and moral. First, individuals or a society have to choose which of these desires it wants to satisfy. Then he/she has to also choose ways of organizing the scarce resources in order to maximize the utility of the available resources. There are multiple alternatives of organizing resources. Agreement or contract plays central role in the process of organizing the resources. The firm is one alternative of organizing resources on the basis of agreement.<sup>11</sup>

A firm may be the results of an agreement to cooperate between persons to bring together available resources that are necessary to produce essential goods/services.<sup>12</sup> For example, imagine a rural family in a village in Ethiopia where there is no mill. Since it is either impossible or uneconomical for each family to build a mill, the families in the village would have to pool their money and resources to build a mill. Specialization and exchange could also be a factor for cooperative agreements.<sup>13</sup> Investor-owned firms are usually the result of specialization and exchange where the entrepreneur contributes his ability to initiate the cooperative

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<sup>11</sup>Muller, (n 7) 54

<sup>12</sup> Martin Ricketts, *The Economics of Business Enterprise: An Introduction to Economic Organization and the Theory of the Firm* (3<sup>rd</sup> edition, Edward Elgar Publishing Ltd, 2002) 5

<sup>13</sup> Ibid 7

agreement/business ideas, the capitalists contribute capital necessary to bring the business idea into reality and the managers contribute their ability to monitor the enforcement of the contract.<sup>14</sup> It may be argued that the problem of specialization would be solved by market exchange, but such a transaction at an individual level would be enormously costly.<sup>15</sup> Hence, one major reason why firms are formed and survive is transactions costs on individual level.<sup>16</sup> Firms may also use alternative methods of risk management. An entrepreneur may opt for a firm to implement his new ideas even when he possesses sufficient capital to finance the introduction of the new ideas himself. This is because an innovative idea is a risky asset, as he does not want to exchange his relatively safe property with a new, riskier asset. He wants to get someone else to share the risk.

One may argue that the above benefits of a firm may be reaped through informal relations among the concerned individuals. However, the necessary cooperation burdens the individuals with moral hazard, lack of certainty and a lack of flexibility. "Moral hazard exists when the probability of a given 'state of the world' occurring is influenced by one of the parties to the contract but when the behaviour of this contractor cannot be observed."<sup>17</sup> This means there is a possibility for an individual to cheat in the cooperation. He may become superior by not conforming to the behaviour required for the cooperative solution.<sup>18</sup> Firms reduce this hazard by providing for a well specified and complete agreement and monitoring mechanism. The memorandum and articles of association transforms informal cooperation into a formal one which can easily be invoked in the court of law by aggrieved party. Even when rights and duties are incomplete or unspecified due to the parties' inability forecast the future, management would fill such gaps. More importantly in a firm there is a third party, a manager, which monitors compliance with the agreed deal and punishes a party to the cooperative agreement who cheats. Firms also allow flexibility, since a party could withdraw from the cooperative agreement by selling his shares without it leading to the possibility of total collapse of the cooperative agreement. It is economic rationality to adjust one's own economic activities to continually changing conditions and to utilize new information.

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<sup>14</sup>Muller (n 7) 62-65

<sup>15</sup> Ricketts (n 1) 17

<sup>16</sup> Ibid 17

<sup>17</sup> Ibid 34&43

<sup>18</sup> Muller (n 7) 55

## **2.2 Theory of firm ownership<sup>19</sup>**

This subtopic intends to show that the cooperatives may be solely the result of economic choice. These are rational choices such as the cost of contracting (transaction costs) and cost of ownership (management and risk bearing costs).

### **2.2.1 Ownership to those having a transactional relationship with a firm**

It is possible to imagine that a firm is owned by someone who has no transactional relation with the firm. For example, the entrepreneur who initiates the business idea may organize the firm by borrowing capital from lenders, by purchasing inputs and selling output on the market. However, such a type of a firm is likely to be quite inefficient, especially when there is no effective competition. In an imperfectly competitive market, the party that has a dominant position would exploit the weaker party. If the seller of a raw material is in a dominant position he will under normal market conditions abuse his position to the detriment of the firm. This is the cost of transaction.<sup>20</sup> This cost may be minimized if the firm is assigned to (or if the firm owners are) the suppliers of the raw material. To assign ownership to someone who has no transactional relation with the firm would waste the opportunity to use ownership to reduce transaction costs. Cost minimizing is an issue of survival for a firm. Higher cost forms of organizations tend to be driven out of business by their lower cost competitors. If a particular form of ownership is dominant in a given industry, this is a strong indication that this form is less costly than another form of ownership would be in that industry.

### **2.2.2 Cost of Contracting and Cost of Ownership**

We have seen that ownership of a firm should be assigned to those who have a transactional relation with the firm, but since there are multiple parties that have transactional relationship with the firm, it is also important to choose among those parties. If all become owners of the firm it turns to a subsistence production only for the daily need of the owners. Since this form of production does not recognize specialization it is carried out at low level of economic development at a family level. Moreover, making everyone an owner increases the cost of

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<sup>19</sup>Unless otherwise expressly stated all discussions under this subtopic are adapted from Ricketts (n 1) 26-56

<sup>20</sup> Here the phrase 'transaction cost' is used in its wider sense. For further details see Ricketts (n 12) 27-38

ownership, since participants are likely to have radically diverging interest.<sup>21</sup> Therefore, only some of those who have transactional relation with the firm should be its owners.

### **A. Cost of contracting**

Cost of contracting would be minimized if ownership is assigned to those who become losers, when price is determined by normal market mechanisms. They may be a loser in the market because of market failure due to one or more of the following reasons.

#### **Unfair trade practices<sup>22</sup>**

Frequently exposed to unfair trade practices that affect them, clients of the firm have an incentive to own the firm and thereby avoid price exploitation. Some service sector economies such as electricity, water, sewerage, and telecommunications industries are prone to monopoly control. The firm owners may unfairly exploit consumers. In these areas it minimizes cost to organize the firm as consumer cooperatives. Moreover, where there is only one buyer (firm) and many suppliers (a monopsony) the suppliers would be motivated to become owners. Many nineteenth century agricultural marketing and processing cooperatives in North America were the result of monopsony. In such circumstances, cooperatives would strengthen the future of consumption of the consumers by enabling them to save money that they would have paid to the dominant firm. Moreover, low prices would encourage the consumer to consume more and excess consumption may affect savings.

#### **Gradual labour specialization &immobility**

When an individual joins a labour market for the first time there are likely to be many employers that offer employment. This is because a new entrant into the labour market is mostly a generalist that can fit to the demand of many firms. Even when the market is not available for his skill he can take training to fit with the market demand. He could also be flexible about the work place which increases the number of firms that compete for his labour.

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<sup>21</sup>Cost of ownership is further discussed under the next sub-section

<sup>22</sup>Unfair trade practice includes abuse of market dominance, cartel, merger of business enterprises and unfair competition. See Trade Practice and Consumers' Protection Proclamation No. 685/2010

However, after he has taken a job with a particular firm and worked for a number of years his skills are likely to become specialized to the firm he works for. The worker might have invested in his skill for specialization in the area he has been working. Thus he may be substantially more productive at this present firm than he would be elsewhere. The age of the employee may also reduce his incentive to retrain. Moreover, the worker may have made important personal investments in the community where his employer is located, investments that cannot be recouped if he leaves that community.<sup>23</sup> His spouse may be employed there, his child may attend the local school system, and his entire family may have developed strong personal ties with other members of the community. This inflexibility would give the employer the opportunity to exploit the employee.

The employee, who realizes such a problem affects him, is likely to insist on higher initial wages or refuse employment with a firm that, though otherwise an attractive if the employer cannot effectively bind itself not to act exploitatively in the future. Likewise, after accepting employment with the firm he will have suboptimal incentives to take firm specific trainings that are valuable to that firm. Such may substantially reduce the productivity of his labour. He also lacks the necessary incentive to buy a house that suits his special desire but might be difficult to resell. The worker may not be incentivized to interact with the society. This means the workers remains unsatisfied and the local community also loses the opportunity to benefit from his participation in public life. Social solidarity would also be loosened and the culture of the community would be eroded. Such costs would be minimized if workers have ownership assigned to them since what they lose as an employee, they would recoup as an owner.

### **Inflation**

Firms and their clients often prefer to enter into a long term contract in order to avoid the opportunistic behavior that arises due to transaction-specific investments. Long term contracts could also be taken as a means of risk-sharing between the parties. It also mitigates the possibility of adverse selection.

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<sup>23</sup>In Ethiopia there is a social solidarity called “Edir.” People of the same village in urban areas and the same Kebele in rural area form an association that perform burial ceremony. Members make monthly contribution in cash or in kind. A member can receive benefit if his family member dies. Moreover; in Ethiopia there is a wide spread custom of preparing their own tomb in the locality church.

However, inflation is a serious challenge to long term contracts. As conditions change during the terms of the contract, the price(s) specified in the contract can produce substantial windfall gain for one party and a corresponding loss for others. Making clients the owners of the firm eliminates much of this risk. What the client loses as a client he gains as an owner and what he loses as an owner he gains as a client.

### **Asymmetric information**

Contracting can also be costly when the firm has better information than its clients concerning the matters that bear importantly on transactions between them or, conversely when the clients have better information than does the firm. For example, a firm often knows more than its customers about the quality of goods or services that it sells. This is especially common when the contracts for goods or services are complex or difficult to inspect. The firm then has an incentive to deliver a lower quality performance than it promises. Customers, in turn, have an incentive to distrust the firm and may offer to pay only the value of the worst possible performance or decline to purchase at all. The result is inefficient transaction. Although the customers may be getting just what they are paying for, and the firm is getting paid no more than it is necessary to cover the cost of the quality of the performance it is providing, both the customers and the firm would prefer a higher quality performance and a higher price. Firms can sometimes manage this problem by investing in a reputation for quality, but that strategy generally takes time and can often provide at least a partial palliative. Customers' ownership reduces such cost.

## **B. Cost of ownership**

Ownership of a firm has two major costs. These are management costs and cost of risk bearing. Management cost can further be classified into agency costs and collective decision making costs. All these costs can vary substantially in magnitude from one class of ownership to another.

### **Agency Costs**

This cost relates to the control of the board of directors and managers. Usually owners of large firms delegate substantial decision making powers to board of directors who in turn delegate most of such powers to hired managers. The owners necessarily incur costs in their effort to



control this agent's monitoring costs. There are also costs that result from the failure to monitor managers with perfect effectiveness which can be known as the managerial opportunism cost.

In order to monitor the manager, the owners need information about the operation of the firm. They have to communicate this information among themselves and also persuade each other to reach a decision. Finally they have to apply the decision. This is the monitoring cost. This cost is less for those who have frequent transactions with the firm. Moreover, cost of communicating among the owners would be reduced if all or most of the owners are residing in the same locality. This means cooperative form would reduce monitoring cost.

Whenever monitoring is not carried out to the expected level, managers probably abuse their decision making power. Although managers self-dealing and laziness may be controlled by legal, contractual, moral and market mechanisms, it is difficult to control excessive retention of earnings. Excessive retention is likely to bring approval to the manager both from inside (from workers of the firm) and outside. Retentions benefit a manager by creating a buffer against adversity and by increasing the size of the firm that he controls. The invisible hands of the market selection tend to support excessive retention since retention enhances the survival of the firm. But retentions are costly to the firm's owners if the rate of return on the retentions is less than the return available on investment outside the firm or if regardless of the rate of return the retention brings, the fund retained can never be recovered by the current owners.<sup>24</sup> Such cost may be reduced by assigning ownership of the firm at least partly to the manager.

### **Collective decision making costs**

This cost is the cost that emanates from heterogeneity of interests among owners. Heterogeneity of interest may lead to decisions whose outcomes fail to maximize the aggregate welfare, or surplus of the owners as a group. Decisions are made by vote schemes, with votes assigned either on the basis of democratic principles or in proportion to the transactional relationship the owner

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<sup>24</sup>For example, Cooperative Society Proclamation No. 147/1998 does not clearly indicate whether a member who leave the cooperatives or dismissed from membership collect the share capital he paid or whether he is entitled to the capital gains of his investment. The law leaves the matter to be decided by the majority. See Art 15 of the Cooperative Society Proclamation No.147/1998. The only option that he has is to sell his share. See Ibid Art 19. Even in that case the fact that only residents can become a member and the membership has to be accepted by the general meeting clouds the right to transfer the share thereby making excessive retention too painful to the owners.

has with the firm. If we assume that owners are rational egoists who do not want to sacrifice even tiny benefits of their own to the benefit of other owners, then there is a possibility that the majority would pass a decision that benefits them but may affect the aggregate outcome. Heterogeneity of interest increases when the owners are suppliers or purchasers or employees of the firm. This means this cost is high in a cooperative form of ownership and less in investor-owned form of ownership.

There are also the costs of the decision making process itself. To make a rational vote an owner has to invest based on information concerning the firm and about the preference of other owners. There are also costs of meeting and implementation of effective decisions.

### **Risk bearing costs**

In addition to management cost ownership is also associated with risk bearing cost. One class of persons having a transactional relationship with the firm may be in a much better position than others to bear those risks. Although investor-owned firms are usually considered efficient in reducing risk by bearing costs, consumer cooperatives may also be in a good position to bear the risk of enterprises. This is particularly true where the goods or services involved are a small fraction of the customer's budget or where the customers are themselves firms that can pass the risk on to their own owners or customers.

## 2.3 Governance of investor-owned firms

Here governance is intended to refer to the management organs and their powers, responsibilities and accountabilities. One of the important points that distinguish firms from other contracts is the existence of governing bodies. The governing bodies complete and specify when the time reaches, rights and duties which may be incomplete or unspecified due to the inability of human beings to properly forecast the future. More importantly in a firm there is a necessity for enforcing such contracts internally. Governance is completing and specifying incomplete and unspecified rights and duties (decision-making) and also enforcing the contract. Thus it is an extension of ownership right and fall in the theory firm ownership.

The decision-making is mainly the power and responsibility of shareholders and the board of directors. Enforcing or executing the contract is the power and responsibility of the manager. The management may be designed to the ultimate benefit of the owners of the enterprise, the management personnel, or the public depending nature of shareholding, economic, legal, cultural and political mechanisms.<sup>25</sup>

This subtopic intends to show that the choice of the form of ownership could also be affected by the legal limitation imposed by the law on owners to manage their firm. A firm works towards public purpose if its management is accountable to the public. This is shown by showing that investor-owned firms could be made to work for the benefit of the public if its management is made accountable to the public than to the shareholders. This implies that cooperatives may end up in profit maximizing mission if the management is made accountable to the members only without having any form of public accountability.

### A. Separation of Ownership from Control Thesis<sup>26</sup>

According to separation of ownership from control thesis set out by Adolf Berle and Gardiner Means in *Modern Corporation*, business had undergone an evolution from control through complete ownership, to majority control, to control through legal device, to minority control, and

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<sup>25</sup> See Lorraine Talbot, *Critical Company Law* (Routledge-Cavendish, 2008) 107

<sup>26</sup> Unless otherwise expressly stated all discussions under this subtopic are adapted from Talbot Ibid 106-190

finally to managerial control. Historically, capitalism in the United States began with individuals or partnerships of individuals who fully owned and controlled the business. Gradually, corporate ownership became widely dispersed and there were no shareholders who had a majority share in the capital. At this time shareholders were trying to protect their interest through the application of law and contract. Over time the majority of shareholders lost interest in control of the corporation. This opened a room for minorities to influence the management. In the twentieth century, shareholders became too powerless and too passive due to the further dispersal of ownership. This was the final stage of evolution of control which resulted in a shift of power from those that owned the corporation, shareholders; to those that controlled it, the board of directors and managers.

### **B. Implication of separation of ownership from control<sup>27</sup>**

If corporations are not controlled by owners, then they are controlled by professional managers. Rights and duties which were not completed and/or not specified in the memorandum of associations are to be completed and specified by the management. This implies that the policies of corporations are made by professionals. This has three alternative effects. The first effect is that managers would be loyal to owners and make policies that maximize profits which go to the owners. The second alternative is that the management may make policies and decisions that benefit the management personally. The management members may even be shareholders themselves but pro-management decisions such as large bonuses and excess retentions would benefit them more than pro owners' decisions would benefit them. The third alternative is that the management exercises its control powers to attain social goals. The alternative that the management chooses depends on the business culture, political, economic and legal circumstances.

In a business culture, where there are high ethical standards that individuals are committed to follow, the management would less probably pass self-serving decisions. In such a culture, self-serving decisions would be taken as a betrayal of one's own world. So the management would either be pro-owners or pro-social goals. Political circumstances would also matter a lot. The management would be influenced by public opinion and government interferences. In a liberal

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<sup>27</sup>Unless otherwise expressly stated all discussions under this subtopic are adapted from Talbot. Ibid 106-190

political system, the managers would probably be pro-owners. In an egalitarian political system the management would incline to social goals such as customer welfare, employee benefit and environmental issues. The existence of a high rate of unemployment for professionals or the lack of a competitive labour market may also discipline the management into working towards the interest of the owners' goals or social objectives.

Legal mechanisms are the most important disciplining factors. In a liberal economy, the law is designed to protect the interest of the owners. This law provides all possible mechanisms that would safeguard the interest of owners including, but not limited to, a duty of good faith, liability of the owners for failure to act properly and timely, dismissal notwithstanding contractual terms, and liability to creditors. Generally, such law makes the management answerable to the interest of the owners', which is best expressed as an objective to maximize profits. On the other hand, in a state controlled economy, the law does everything to make sure that the corporations are public organizations that safeguard the interest of those who deal with it, either as suppliers of raw material, suppliers of labour, as purchasers or as a community where the investor-owned firm functions. The management is accountable to the public not to the owners. This means the investor-owned firm could be made to serve the public purpose. If the law is silent/vague/ambiguous on the accountability of the management and, more importantly, if the judiciary is partial, inefficient and the state administrative machineries are corrupt, the separation of ownership would highly probably lead to the sequestration of the firm by the management personnel to their own benefit.

## 2.4 Conclusion

Thus this Chapter shows that there are valid economic reasons that may push entrepreneurs to organize their business in the form of cooperatives. This could be understood from the definition of firm, theory of firm, theory of firm ownership.

Firm is a nexus of contract. This means it is a series of transactional relationship between the parties to the contract. Cooperatives could possibly one type of firm. This because the characteristics of a firm are that there is transactional relationship between the firm and owners of the firm. Normally investor owned firms parties to the next are lenders of the firm that means they have given certain amount of money to the firm and receive the interest in the form of dividend. Likewise, in producer cooperatives members are suppliers of goods to the cooperatives and receive interest on their supply in the form of surplus. Similarly, in consumer cooperatives the members are purchasers of goods/services from the cooperative and receive interest on their purchase in the form of surplus. The same could be said for workers cooperative. So both in investor owned firms and cooperative owners (parties to the transactional relationship) receive benefit from the firm on the basis of the amount of transaction they have made with the firm in the previous accounting year. Investor owned firms are nothing more/less than lenders cooperatives.

Firm is the result of economic rationality. It reduces transaction cost that may exist on individual level of transaction. It also distributes risk among the members. Moreover; firm highly reduces the risk of non-compliance that exists in the individual level of transaction. Firms reduce this hazard by providing for a well specified and complete agreement and monitoring mechanism.

Once individuals decide that it is wise to have a firm, they proceed to decide what type of transactional relationship they need to have. Such decision also depends on theory of economic rationality. They choose the relation that best advances their economic interest. The choice either to become a money lender or supplier of goods or purchaser of goods/services or supplier of labour is an economic choice. Transaction cost, ownership cost and management cost are major points to be considered in such choices. For example cooperative form of transactional relationship may be more appropriate choice to reduce unfair trade, to avoid the risk of

asymmetric information, to reduce the negative consequence of inflation and labour specialization. Lender-borrower relation may be preferred to reduce cost of ownership such as agency cost and collective decision making cost.

As an extension of ownership cost, the extent of management freedom given to the owners by the law also matters a lot in making the choice. Normally in investor owned firms (lender-borrower relation) the law gives wider power to the owners to manage the firm and control the management body. But that may not always be true specially in a legal system that inclines to give the government power to control the private sector. If in such legal system cooperative form of transaction gives wider autonomy to the owners such transactional relationship may be an economic choice.

In Chapter One we have seen that for various reasons cooperators have been borrowing many of the ideas of companies thereby overlapping cooperatives on companies. In this Chapter we see that entrepreneurs may overlap companies on cooperatives. In the subsequent chapters (Chapter Three to Eight) we examine whether the Ethiopian Legal System is capable of avoiding or at least reducing the possibility of such overlapping.

## CHAPTER THREE

# COMPREHENDING COOPERATIVES UNDER ETHIOPIAN COOPERATIVE LAW<sup>1</sup>

### 3.0 Introduction

True Cooperatives are half way between associations and investor-owned firms.<sup>2</sup> Associations<sup>3</sup> are the main mechanism by which free citizens in a free society can participate in the public sphere of the society, whereas investor-owned firms are the means for free citizens to participate in the free economy.<sup>4</sup> Charities are one form of association where people act collectively to solve public problems such as poverty, illness, crime and illiteracy. Like charities, cooperatives are working for those who are economically disadvantaged and the ultimate objective is to enable that disadvantaged individual to get out of poverty, or to obtain a fair share of the free economy; profit maximization is not their ultimate agenda. Moreover, like charities, in cooperatives there is also a sense of assisting and supporting others, although in the former the assistance is to non-members and in the latter the assistance is to members only, and the assistance has to be reciprocated. Like investor-owned firms, cooperatives raise capital from those who ultimately and directly benefit by the establishment and existence of the cooperatives. Much like investor-owned firms, cooperatives have profit and loss accounts or balance sheets. In some small way this indicates that the laws governing cooperatives needs to be a balanced hybrid of the law of charities and the law of investor-owned firms.

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<sup>1</sup>Notice that the issue of federal vs. state jurisdiction may be raised at this juncture although this research has no intention to answer such issue. This research assumes this law as a law applicable to all cooperatives in Ethiopia for three main reasons. Firstly, jurisdiction is not an issue in this research. Secondly, cooperative laws are universal. And thirdly, Ethiopian federalism inclines to unitary state structure because of vanguard party system where EPDRF and its allies rule all member states with almost no opposition parties both in the federal and state legislation and which does not seem to change very soon.

<sup>2</sup>Christopher Merrett and Walzer, Norman (eds), *Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century*(ME Sharp, 2004) 24

<sup>3</sup> An association is a grouping formed between two or more persons with no view of securing direct financial benefits but with a view to obtaining exclusively charitable purpose or with a view of promoting the rights and interest of its members. The Civil Code of Ethiopia of 1960 Art 404 in combination with Charities and Societies Proclamation No.621/2009 Art 14 and 55

<sup>4</sup> Ibid



This chapter intends to show that although the special privileges given by the Government to cooperatives leads one to believe that there should be distinction between cooperatives and investor-owned firms, reference to the definition, the ultimate objectives, formation or liability of cooperatives do not assist in establishing such a distinction. I argue here that this is a logical conclusion when the comparative analysis of the law relating to both cooperatives and investor-owned firms is taken into account.

To that effect I examine the special privileges, definitions, ultimate objectives, formation and liability of cooperatives on the basis of the Cooperative Society Proclamation No.147/1998. Academic literature is used to elucidate the concepts that are incorporated in the Cooperative Society Proclamation No.147/1998.

### **3.1 Special privileges of cooperatives in Ethiopia**

The main reason why we need to keep clear the distinction between true cooperatives and investor-owned firms is because the Cooperative Society Proclamation No.147/1998 recognizes special privileges for cooperatives. In order to justifiably get such special benefits, a cooperative has to enable the public to attain certain defined objectives. It is difficult to imagine that the privileges are arbitrarily given. If the cooperatives' end up having the same profit maximizing objectives as the investor-owned firms they should no longer receive these privileges. So the special privileges account for society's belief that cooperatives are different from investor-owned firms.

This subtopic is intended to show that there are special benefits designed for cooperatives in exclusion of investor-owned firms. As the Ethiopian Government has been in power, it is an interventionist government and there are benefits for investors.<sup>5</sup> These benefits are conditional upon policy considerations such as export promotion, import substitution, poverty reduction, wealth inequality reduction and possibility of curbing outflow of profit from foreign direct investment.<sup>6</sup> In these cases, the form of organization for the investment is of no significance; it

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<sup>5</sup> The incumbent government of Ethiopia claims to be developmentalism. See further discussion in Chapter six

<sup>6</sup>The benefits include among other things, land allotment, access to loan, tax holiday/exemption, and preference in government procurement. Although in principle urban land is accessible only through auction, manufacturing

may be sole proprietorship or investor-owned firms, public enterprises or cooperatives.<sup>7</sup> The benefits we discuss here is only those benefits that depend solely on the form of the organization of the investment-cooperative form of investment. These benefits are: priority claim, set-off, freedom from attachment, longer period of limitation of action, and government assistance. These are discussed in detail below.

### **A. Priority Claims**

The issue of priority claims becomes important when a debtor has plurality of creditors and there is a possibility that his asset is not worth enough to pay all his creditors. To avoid such a risk of insolvency for the debtor, creditors may get priority claims on identified properties of the debtor either by a contract, a law, a judicial decision or a will.<sup>8</sup> The priority claim extends to the property indicated by the legal mechanism used to transfer its right. A creditor having such a priority right is paid out of the proceeds of the sale of the property before all other creditors.<sup>9</sup>

The law that gives priority claims for the creditor (state) on all properties of the debtor is Ethiopian tax law.<sup>10</sup> It is obvious why the tax obligation takes priority over all other obligations because tax is the major source of revenue for the Government who has the legislative power to determine its payment priorities. If the State does not collect enough revenue, it is difficult to

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enterprises and “projects having special national significance” may be given land by allotment at a bench mark (lowest) lease price. See Urban Land Lease Holding Proclamation No.721/2011 Art 7(2), 12, 14 & 2(11). Rural Land is made available to any investors who want to invest in agriculture and has received investment permit. See the Federal Democratic Republic of Ethiopia Rural Land Administration and Land Use Proclamation No.456/2005 Art 5(4(b)) cum Investment Proclamation No. 280/2002. Foreign investors are privileged to open and operate foreign currency accounts and they have the right to make remittance out of Ethiopia.(Ibid Art 19). Investor that engages in manufacturing, agro-industrial activities or the production of agricultural products and exports at least fifty percent of his product or supplies at least seventy –five percent of his product to an exporter as production inputs is entitled to tax holidays. See Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation No.84/2003 Art. 4-7. There is also custom duty exemption for import of capital goods. (Ibid Art 8-9). If a resident company or partnership reinvests the profit it earned to raise the capital of another company or partnership such amount shall be deductible from its taxable income. See Income Tax Proclamation NO.286/2002 Art 27(1). Export oriented investments are also charged VAT at a zero rate. See Value Added Tax Proclamation No.285/2002 Art 7(2). In government procurement a preference margin of up to 15% for goods produced in Ethiopia and up to 7.5% for works carried out by Ethiopian are granted in the evaluation process. See Determining Procedures of Public Procurement and Establishing its Supervising Agency Proclamation No.430/2005 Art 19. Micro and small scale enterprises are also privileged to technical training and certification, industrial extension services, government assistance to search for alternative market, facilitation by government of access to loan etc. See Micro and small scale enterprises development strategy support and implementation strategy(in Amharic , Jan 2011 p 36-52)

<sup>7</sup> See Investment Proclamation No. 280/2002 Art 10

<sup>8</sup> See Civil Code of the Empire of Ethiopia of 1960 Art 2825, 3041 and 3117 Pledge and antichresis arise out of contract only where as mortgage may arise from contract, law, will or judicial decision.

<sup>9</sup> Ibid Art 2857 and 3076-3080

<sup>10</sup> See Income Tax Proclamation No.286/2002 Art 80 and Value Added Tax Proclamation No.285/2002 Art 32

imagine the enforcement of other rights. However, the State's priority claim respects the prior secured claims of creditors, and the tax authority has to inform any person, who is in possession of movable property or the organ that registers a mortgage interest of its intention to get priority right on the property.<sup>11</sup>

Although the claim of a cooperative over a member's property does not have priority over the Government's tax claim, it has priority over the prior secured claims of other creditors.<sup>12</sup> The priority claim recognized for cooperatives on the property of a member is even wider than the priority claim of the tax authority. A cooperative is not expected to inform a person who is in possession of movable property, or inform the organ that registers the mortgage, its intention to get priority right on the property.<sup>13</sup> It is very difficult to imagine justifications for such a priority claim especially over the right of prior secured creditors unless a cooperative does not have a significant distinction from investor-owned firms in its ultimate end, in the business it carries out, and by the ethics under which it carries out the business.<sup>14</sup>

If the cooperatives were limited by the law to user owner, user control and user benefit principles the priority claim might have been justified by analogy to the concept of maintenance allowances. Maintenance allowance is the minimum means to feed, to lodge, to cloth and to care for the health of a creditor in a decent manner including funeral expenses having regard to the social condition of the interested persons and local custom.<sup>15</sup> It appears reasonable if a person who provides such a maintenance allowance gets priority over all other creditors for the amount of maintenance allowance he gave.<sup>16</sup> The priority right would also be justified if the debt of a member is a debt he owes to a consumer cooperative that supplied him goods/services on credit basis. A membership contribution to collective producer cooperatives for subsistence may also be justified to get priority over other debts.<sup>17</sup>

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<sup>11</sup> Ibid

<sup>12</sup> Cooperative Society Proclamation No. 147/1998 Art 28

<sup>13</sup> Ibid

<sup>14</sup> These points are discussed in chapters that follow.

<sup>15</sup> See Civil Code of the Empire of Ethiopia of 1960 Art 807 and 824

<sup>16</sup> Ibid Art 816(3)

<sup>17</sup> See Civil Procedure of the Empire of Ethiopia of 1965 Art 404(b)

## **B. Set-off in Respect of Shares or Benefits of Members**

Set-off is possible under the Civil Code which governs the obligation, in spite of the source of the obligation and parties to the obligation.<sup>18</sup> However, there are positive and negative conditions of set-off.<sup>19</sup>“The positive conditions are liquidity, maturity and fungibility.”<sup>20</sup>Set-off shall not occur unless both debts are money debts or relate to certain quantity of fungible things of the same species and both debts are liquidated and due.”<sup>21</sup>Negative conditions are, that there are debts which can never be set-off such as the maintenance allowance, wages, tax obligations, things unjustly deprived or acquired as a result of a bailment.<sup>22</sup>

Now we may ask, is the set-off privilege under the Cooperative Society Proclamation subject to positive and negative conditions provided under the civil code? If the answer is yes, it is no more a special privilege to cooperatives. The fact that Art 29 of the Cooperative Society Proclamation No.147/1998 allows set-off only against shareholding and benefits, seems to support this positive conclusion. However, such a conclusion may make the Article unreasonably redundant since it adds nothing to the civil code.

## **C. Share or benefit not liable to attachment**

In principle, the performance by a debtor of his obligation shall be guaranteed by all his properties and claims.<sup>23</sup> This means without prejudice to priority rights of other creditors, any judgment creditor may demand the attachment and sale of any property or claim of the debtor as a satisfaction of the judgment. However, properties that are used to maintain the debtor, such as for his family, are considered necessary to enable subsistence, could not be liable to attachment and sale.<sup>24</sup>Moreover, benefits of employment injuries cannot be attached.<sup>25</sup>In short, properties and claims that relates directly or indirectly to maintenance are immune from attachment and sale for the satisfaction of debts.

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<sup>18</sup> Ibid Art 1675-677 and 1831

<sup>19</sup>Ibid Art 1832 and 1833

<sup>20</sup> Ibid Art 1832

<sup>21</sup> Ibid

<sup>22</sup> Ibid Art 1833

<sup>23</sup> Civil Code of the Empire of Ethiopia of 1960 Art 1988

<sup>24</sup>Civil Procedure Code of the Empire of Ethiopia Art 404 Also see Civil Code of the Empire of Ethiopia of 1960 Art 816

<sup>25</sup> Labour Proclamation No.377/2003 Art112

Are shares and benefits of a member in a cooperative limited directly or indirectly to maintenance of a member? It would be difficult to believe that cooperative production is necessarily limited to subsistence production. Worker cooperatives' pay subsistence wages to member employees and hence any additional benefit a worker may receive from the cooperative in the form of profit is beyond subsistence. The same logic applies but is more clearly relevant to producer and consumer cooperatives. However, the Cooperative Society Proclamation No.147/1998 relieves any investment in a cooperative from attachment in spite of its amount and purpose.<sup>26</sup> In a situation where cooperatives are free to work towards profit maximization objectives, such a privilege would make cooperatives a beyond the law relating to creditors.

#### **D. Administrative ease**

Compared to investor-owned firms, cooperatives are entitled to some administrative simplicity such as temporary certification, operation without trade license, prolonged period of limitation of action. The detail is provided as follows:

##### *Temporary certificate possible*

To begin operation cooperatives have to be registered.<sup>27</sup> Equally investor-owned firms need to be registered.<sup>28</sup> In addition to serving as a permit to operate, registration is the source of legal personality both for the cooperatives and investor-owned firms.<sup>29</sup> To get registered both cooperatives and investor-owned firms have to fulfill certain conditions.<sup>30</sup> However, cooperatives may be registered and be given a temporary certificate without fulfilling some of the registration requirements.<sup>31</sup> They would be given one year to fulfill the unfulfilled requirements.<sup>32</sup> Similar flexibility does not exist for investor-owned firms.

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<sup>26</sup> Cooperative Society Proclamation No. 147/1998 Art 30

<sup>27</sup> Cooperative Society Proclamation No. 147/1998 Art 9(1)

<sup>28</sup> Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 6(1) and Commercial Code Art 219

<sup>29</sup> Cooperative Society Proclamation No.147/1998 Art 10(1), Commercial Registration and Business Licensing Proclamation No. 686/2010 Art , Commercial Code Art 223

<sup>30</sup> Cooperative Society Proclamation No.147/1998 Art 9(2) and Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 11 and 12 and Commercial Code Art 221

<sup>31</sup> Cooperative Society Proclamation No.147/1998 Art 9 (7) as amended by Proclamation No.402/2004

<sup>32</sup> Ibid

### *No Business License*

Another point of administrative simplicity in favour of cooperatives is the dispensation from obtaining a business license.<sup>33</sup> Registration is enough for cooperatives to engage in any business. It is not necessary to secure an additional trade license. However, unlike cooperatives, no person shall carry on commercial activities without obtaining a business license.<sup>34</sup>

Notice that if cooperatives are limited to engaging in non-commercial activities exempting them from the requirement of a business license is justified. According to Ethiopian Commercial Code an activity is a commercial activity if it is carried on for the purpose of making profit.<sup>35</sup> That means any economic activity that goes beyond providing means of substance and intend to increase the wealth of the operators is a commercial activity.<sup>36</sup> This benefit is justified if cooperatives are limited to subsistence economic activities or are expected of different ultimate object than expected of investor-owned firms.

### *Limitation of Action*

Article 1845 of the Civil Code of Ethiopia provides a ten year general period of limitation for any action.<sup>37</sup> Any claim of rights which has not been brought to court within ten years from the day when the right could be exercised is extinguished by limitation of action. Other parts of the Civil Code and other laws, may provide a different period of limitation of action. A right to invalidate a contract affected by defects in consent extinguishes within two years.<sup>38</sup> Similarly actions of non-contractual liability and insurance contract extinguish within two years.<sup>39</sup> An action of “*Petitio haereditatis*” is barred after three years from the date the claimant become aware of the death of the deceased and is absolutely barred after fifteen years from the date of the death of the deceased.<sup>40</sup> An action arising from an employment relationship is barred by

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<sup>33</sup> Ibid Art 9(6)

<sup>34</sup> Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 31(1)

<sup>35</sup> Commercial Code Art 5

<sup>36</sup> Ibid Art 6-10

<sup>37</sup> Civil Code Art 1845

<sup>38</sup> Ibid Art 1810-1813

<sup>39</sup> Ibid Art 2143 and Commercial Code Art 647 When the non-contractual liability arises from the commission of a criminal offence the period of limitation provided under criminal law applies. The criminal period of limitation ranges from a minimum of two years to the maximum of twenty-five years. See the Criminal Code of the Federal Democratic Republic of Ethiopia Proclamation No.414/2004 Art 217 and 218

<sup>40</sup> Civil Code Art 1000

limitation after one year.<sup>41</sup> The right of the tax authority to amend a tax payer's declaration of tax obligation expires after five years.<sup>42</sup> However, in case where the taxpayer has not declared his income or has submitted a fraudulent declaration, no time limit is provided.<sup>43</sup>

The Cooperative Society Proclamation No. 147/1998 provides a special and comparatively a longer period of limitation in favour of a cooperative.<sup>44</sup> Any right emanating from the contract concluded by a cooperative is barred by limitation of action after twenty years. We can notice here that the period of limitation applies when a cooperative claims against a debtor .i.e. it applies only when a cooperative is a claimant/creditor; it does not apply when a cooperative a debtor and somebody is a claimant/creditor against the cooperative.

### **E. Income tax exemptions**

Under Ethiopian Income Tax Laws investor-owned firms including public enterprises pay income tax at 30% rate.<sup>45</sup> However, the Cooperative Society Proclamation No. 147/1998 exempts cooperatives from income tax obligation.<sup>46</sup> This income tax exemption would be justified only if a cooperative acts as an agent of its members to buy or sell on behalf of each individual member.<sup>47</sup>

### **F. Government assistance**

All the privileges discussed in the preceding sections are privileges given by the legislature. In addition to these privileges the legislator mandates and authorizes the executive to make additional privileges to cooperatives. The areas of mandate are among other things: access to land, access to loans, technical assistance, audit and inspection services, court fees and legal services.<sup>48</sup>

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<sup>41</sup> Labour Proclamation No.377/2003 Art 162 Reinstatement claim expires after three months whereas payment claims expire after six months.

<sup>42</sup> Income Tax Proclamation No.286/2002 Art 71 Other tax legislations contain the same period of limitation.

<sup>43</sup> Ibid

<sup>44</sup> Cooperative Society Proclamation No. 147/1998 Art 31(4) as amended by Proclamation No.402/2004

<sup>45</sup> Income Tax Proclamation No 286/2002 Art 19(1)

<sup>46</sup> Cooperative Society Proclamation No.147/1998 Art 31(1)

<sup>47</sup> See infra foot note 104

<sup>48</sup> Cooperative Society Proclamation No.147/1998 Art 31(1(back) & 2), 36-39

In Ethiopia land is very expensive.<sup>49</sup> The problem with accessibility to land is its expense and shortage of supply. One can legitimately get access to land only from the Government. Government supply of land is very small. So access to urban land is not only a matter of money but also a matter of luck. Accessing land from the Government is a great privilege for cooperatives.

The Government may also facilitate access to loans. In Ethiopia, the financial sector is highly regulated, and the state prioritizes projects. Coupled with the scarcity of capital in the country, getting the Government's blessing either directly or indirectly is very crucial to get access to loan either from banks or from micro and small scale financial enterprises.

Cooperatives could also get training and advice for free. They could also get audit and inspection services for free. The cooperative commission may also institute a claim on behalf of a cooperative against those who might have embezzled the cooperative. Although, unless pauperism is proved no statement of claim can be admitted by a court before the prescribed court fees are paid,<sup>50</sup> the Council of Ministers may exempt cooperatives from court fees.<sup>51</sup> One of the major aims of cooperative commission is to assist cooperatives in all possible respects including searching for alternative markets.

In order to benefit from these privileges an economic organization has to be able to show that it is a cooperative. In the following subtopics and successive chapters we are going to examine the Cooperative Society Proclamation to see whether or not distinguishing cooperatives from investor-owned firms is an easy task in Ethiopia. We consider almost all provisions of the law to search for one that clearly distinguishes between cooperatives from investor-owned firms.

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<sup>49</sup> For example in the fifth round lease auction of December 2013 the land lease price in Addis Ababa ranges from a minimum of two thousand five hundred(2500) to thirty-one thousand one-hundred and ten (31110) birr per square meter. See Addis Lisan News Paper (2006) 21(1) E.C.10-14

<sup>50</sup> Civil Procedure Code Art 215

<sup>51</sup> Cooperative Society Proclamation No. 147/1998 Art 31(3) as amended by Proclamation No.402/2004



## 3.2 Definition

The definition given to cooperatives by the Cooperatives Society Proclamation No.147/1998 pushes cooperatives closer to investor-owned firms than charities. This is because individuals can become a member only if he/she contributes money to the capital. Furthermore, profit/loss seems to be the concern of members despite the fact that cooperatives are merely organizational means to enable individuals to collectively solve common economic and social problems.

The proclamation defines Cooperative Society as follows:

*“Cooperative Society’ means a society<sup>52</sup> established by individuals on voluntary basis to collectively solve their economic and social problem and to democratically manage same.”<sup>53</sup>*

There are five basic concepts in this definition that need detailed explanation in order to understand what cooperatives are. These elements are individuals, voluntariness, collective action, economic and social problems and democratic control.

### A. Individuals

The first important element of the definition is the word ‘individuals.’ Here the word ‘individuals’ must have been intended to refer to both physical and juridical persons because Art 2(3) of the Cooperative Society Proclamation No.147/1998 which define ‘member,’ and Art 6(1) of the same proclamation, which talks about levels of cooperatives, impliedly recognizes that cooperatives may establish other cooperatives. This is more clearly provided in the Council of Ministers Regulation No.106/2004 Art 3 which classifies cooperatives into Primary Cooperatives, Unions, Federations and League. The idea of creating one big cooperative community from combination of smaller cooperative communities has emerged with the

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<sup>52</sup>Art 2(1) of Cooperative Society Proclamation No.147/1998 uses the word ‘Society’ to refer to a cooperative which received registration certificate from concerned government organ. Although there is some inconsistency, the word ‘society’ is used throughout the proclamation to refer to cooperatives after registration and the phrase ‘cooperative Society’ is used to refer to cooperatives until registration. For sake of clarity the word ‘cooperative’ should have been enough to refer to unregistered ones and the word ‘association’ should have been used in place of society in the definition of cooperatives.

<sup>53</sup> The Cooperative Society Proclamation No.147/1998

emergence of Cooperatives.<sup>54</sup> Cooperatives are established by two or more persons either physical persons or artificial persons or a combination of both.

## **B. Voluntariness**

The second important element of the definition is voluntariness. Voluntariness primarily means the free and unrestrained will of a person to be bound by an obligation.<sup>55</sup> This indicates that cooperatives are the result of an agreement where a person decides to be a member after making his own personal judgment about the benefits and responsibilities of becoming a member. No one is forced to be a member; membership depends on freedom of choice.<sup>56</sup> However, unlike investor-owned firms, this freedom of choice is limited by the principle of open membership, which means that individuals would be members of even if the bylaws prohibit admission of new members already.<sup>57</sup>

Voluntariness also means commitment to carry out certain obligations without consideration or with insignificant consideration.<sup>58</sup> This indicates that there is some element of philanthropy in the cooperatives. Those who are a little bit better off either in terms of wealth or skill/knowledge could agree to help other fellow members. Usually in early cooperatives, the fact that distribution of profit, if any, never depended on contribution to the capital, and the principle of democratic management may partly indicate that those who have money agreed to help those who have less or none.<sup>59</sup> The principle of open membership and cooperation<sup>60</sup> could also be justified on the basis of voluntariness. Early cooperatives were the result of philanthropists in early nineteenth century Britain out of which they gradually developed into mutual self-help which still contained some form of philanthropy.<sup>61</sup> In the contemporary period, there are cooperatives organized by

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<sup>54</sup>Arnold Bonner, *British Cooperation The History, Principle and Organization of the British Cooperative Movement*(Co-operative Union Ltd, 1961) 28

<sup>55</sup>Henry Black, *Black's Law Dictionary*(4<sup>th</sup> edition, West Publishing Co, 1968) 1747

<sup>56</sup>For further discussion on state action that may impend freedom of choice see our discussion on principle of voluntarism infra.

<sup>57</sup>For detail see our discussion on principle of open membership in chapter four.

<sup>58</sup>Black (n 54) 1747

<sup>59</sup> However; these matters may be taken as a technical nationalization of private property in the communist ideology which makes voluntariness an empty concept. In a system where there is protection of private property it is possible to justify democratic management and disregard capital contribution in profit sharing as charitable action. See further discussion under principle of voluntarism.

<sup>60</sup> These two principles are discussed in a little more detail under principles of cooperatives.

<sup>61</sup> Peter Davis and Martin Parker, 'Cooperatives, Labor, and the State: The English Labor Economists Revisited'

philanthropists but owned and managed by members.<sup>62</sup> This concept of voluntariness is the one main feature that distinguishes cooperatives from investor-owned firms. In investor-owned firms, profit distribution and management depend on share capital. Members of investor-owned firms compete not only jointly against other investor-owned firms but also internally against each other. Cooperatives do not normally compete jointly against others or individually against each other.

However; the Ethiopian legislator must have used the word ‘voluntary’ to refer to freedom of choice only and not to commitment to help other members. This is because although the freedom of choice is recognized throughout the whole text of the Cooperatives Society Proclamation No.147/1998, there are provisions in the proclamation that obfuscate the commitment to help other members. One of these provisions is Art 5(2) which declares profit distribution to be on the basis of share capital.<sup>63</sup> The other provision is Art 13(2) which makes contribution to a capital a mandatory requirement to be a member of a cooperative; only those who are able to pay share capital and registration fee can become a member (willingness to use the service of the cooperatives and declaration to pay share capital latter on is not enough). In investor-owned firms contribution to share capital and profit share proportionate to share capital are building blocks.<sup>64</sup>

### **C. Collective solution**

This concept further reinforces the necessity of members’ commitment to help other members. Cooperation is one of the three alternative ways of achieving goals.<sup>65</sup> The other two alternatives

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(2011) 39(4) Review of Radical Political Economics 522; Hebe Spaul, *The Cooperative Movement in the World Today* (Barrie and Rockliff, 1945) 16

<sup>62</sup> See our discussion in chapter one.

<sup>63</sup> For further analysis of this issue see our discussion Principle of Cooperatives.

<sup>64</sup> See Art 252, 270, 295, 345(2), 510 of the Commercial Code of Ethiopia. However; two points need to be noted here. The first is that in partnership the law presumes equal distribution of profit unless otherwise agreed.. In partnership members are mostly family members or close friends where there may be some form of assisting each other (cooperating to solve family economic problems) rather than pure profit earning objectives. Secondly, contribution is also according to the means available to each member and that is why the law allows contribution of labour as capital which is not possible in company. These two points by themselves make the Ethiopian Cooperatives closer to company than partnership thereby reducing the possibility of quasi charity concept in cooperatives. See Art 229(1), 295, 303, 304, and 312

<sup>65</sup> Richard Williams, *The Cooperative Movement: Globalization From Below* (Ashgate Publishing Ltd, 2007) 38

are competition and individual effort.<sup>66</sup> These are the three alternative models of doing carrying out economic activities.

Cooperation is ‘a game in which all players attempt to accumulate points for the entire group by using their unique capabilities and talents.’<sup>67</sup> Cooperativism presupposes that everybody has some potential and no one is complete by himself. If everybody properly utilizes their potential then everybody benefits. Likewise, if someone fails to properly utilize their potential, all the other members would lose some of the benefits. In a cooperative, collective action is core and, for a cooperative goal to be achieved, members have to help and encourage each other.<sup>68</sup> This further implies that in cooperatives the most important thing is individual members themselves rather than the money they bring in to the cooperatives as a working capital. This is the cooperative model.

In contrast, the competition model, which is the main characteristics of the action of investor-owned firms, renders the collective action of shareholders/members unimportant. What is important here is that each member has to carry out her own contractual obligation as indicated in the partnership agreement and other legislation.<sup>69</sup> The success or failure of the shareholder/member does not depend on the success/failure of other shareholder/member. To the contrary, sometimes the failure of some shareholders may even be an implication of success of other shareholders/members. Collective action is necessary in investor-owned firms until the partnership agreement is signed. Even this initial cooperation is not necessary in a model of individual effort of attaining goals.<sup>70</sup> This last model is the characteristics of sole traders.

In the Cooperative Society Proclamation No.147/1998 the element of collective action makes a clear distinction between cooperatives and investor-owned firms. As indicated under the objectives of cooperatives, they are expected to be established to solve problems that necessitate collective action.<sup>71</sup> The emphasis of individual ethics is also an implication of collective action

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<sup>66</sup> Ibid

<sup>67</sup> Ibid emphasis added

<sup>68</sup> Ibid 39

<sup>69</sup> A Partnership agreement is a contract whereby two or more persons, who intend to join together and to cooperate, undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and loss arising out thereof, if any. See Art 211 of the Commercial Code.

<sup>70</sup> Ibid

<sup>71</sup> Cooperative Society Proclamation No.147/1998 Art 4 Further discussion on objectives of cooperatives is made infra.

since collective action is better governed by ethical rules than pure legal or contractual rules.<sup>72</sup>The general meeting<sup>73</sup> is empowered to dismiss a member who has not been behaving properly, and hence negatively affecting the collective interest,<sup>74</sup> and a member is admitted by the decision of the general meeting.<sup>75</sup>The principle of the education and training to members and even to non-members,<sup>76</sup> and the principles of cooperation internally among members and externally among cooperatives<sup>77</sup> are indications of the need of collective actions in cooperatives. Article 46 in Cooperatives Society Proclamation No.147/1998 which makes conciliation and arbitration a mandatory mechanism of dispute resolution among members and between members and the cooperatives<sup>78</sup> also implies the existence of collective action in cooperatives. In investor-owned firms, since their relationship is governed by contract and hence never depends on individual behaviour and diligence, no member can be dismissed by the decision of shareholders' meeting.<sup>79</sup>Since there is free transfer of shares in investor-owned firms,<sup>80</sup> and the share is an incorporeal chattel, it is considered as things capable of making up the inheritance.<sup>81</sup>Thus, anybody who happens to be an heir under the law of succession automatically becomes shareholder.

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<sup>72</sup>Williams (n 65) 38

<sup>73</sup>Further discussion about general meeting is made under Ownership and Management in Chapter six.

<sup>74</sup>Cooperatives Society Proclamation No. 147/1998 cumulative reading of Art 13(3), 15(2) and 20(10)

<sup>75</sup>Ibid Art 19(2&3)

<sup>76</sup>Ibid Art 5(5)

<sup>77</sup>Ibid Art 5(6)

<sup>78</sup>Ibid Art 46

<sup>79</sup>See Art 261 279, 295, 303, 425, 464(2) and 536 of the Commercial Code. Expulsion is possible in ordinary partnership and joint venture. Even in these cases it can be done by the court only. As indicated under footnote Supra No.13 ordinary partnership is created by family members or close friends who considers personal etiquette important element of the organization. Incidentally Ordinary partnership is not a trader. This means it does not give unnecessary attention to profit making. See Art 213 of the Commercial Code.

<sup>80</sup>However, free transfer of share applies to public (share) company and private limited company only. See Art 333(2) of the Commercial Code. In partnership and limited partnership membership can be transferred only up on the consent of other members. In ordinary partnership the consent of all other members has to be obtained to transfer membership rights and duties. In Joint venture and General partnership also unanimous consent is required unless a majority decision is agreed upon in the memorandum of association. In limited partnership a majority vote of all partners is enough. In private limited company there is no limitation on internal transfer but for a transfer outside the company the consent of majority holding at least seventy five percent of the capital is necessary. See Art 250,274, 282(2), 302 and 523(2) But we need to bear in mind that the principle of open membership in cooperatives which implies that the decision of general meeting to admit or not to admit someone as a member relates to his etiquette only as far as he consent to use the service of the cooperatives. In contrary in partnership the concern of the partners goes beyond the etiquette and may include unwillingness to share the profit with the new comer or doubt on her solvency since partnership has unlimited liability and partners are guarantor to each other.

<sup>81</sup>Civil Code of the Empire of Ethiopia of 1960 Art 826(2) cumulative Art 1128 cumulative Commercial Code Art 325, 524 and 715 Notice here that the issue of succession has no place in partnership since the death of a member dissolves the partnership(Art 260(1), 295 &303).

#### D. Economic and social problems

This phrase contains three different but interrelated words: economic, social and problem. Robert Owen created his village of cooperatives to replace the competitive and market oriented economic system with a cooperative form of economy.<sup>82</sup> The Owenite movements involved business enterprises in which the workers decided to trade with each other<sup>83</sup> and they were the result of the advocacy of British Labour Economists who believed that the separation of ownership of the means of production from labour was the root cause of labour's dependency and poverty.<sup>84</sup> The immediate objective of Rochdale Pioneers, which is a model of many modern cooperatives in all corner of the world, was "to free themselves from adulteration and credit system of the little shop keepers and the 'truck shop' of the employer."<sup>85</sup> In North America, early cooperatives were formed to enable small farmers to adapt to the market economy of the 19<sup>th</sup> century.<sup>86</sup> Generally, like investor-owned firms, cooperatives are undertaking economic activities.

However, unlike investor-owned firms and like charities, cooperatives intend to address social issues.<sup>87</sup> From the very inception of the idea of the cooperative, cooperatives have been struggling to solve social problems such as poverty, economic inequities, crimes and social segregations. Robert Owen had a belief that cooperatives could be a solution to two very crucial social issues of his time namely mass poverty and moral impurity.<sup>88</sup> The Owenites, Rochdale Pioneers, and the latter British Cooperative Movement had the social objectives of attaining among other things economic equality, fair price and quality products.<sup>89</sup> In North America "cooperatives were a way to contest the meaning of modernity-farmers protesting urban centred policies, regions or classes resisting economic domination by others, idealists fighting secular values, or citizens revitalizing their communities in the face of adverse forces."<sup>90</sup>

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<sup>82</sup>Bonner (n 53) 11

<sup>83</sup>Davis (n 61) 528-532

<sup>84</sup>Ibid 528, 530 and 532

<sup>85</sup>Sidney Webb, *The Consumers' Co-operative Movement* (Cornell University Library, 1921) 1. See also Stephen Yeo (ed), *New views of Co-operation* (Taylor and Francis, 1988) 48

<sup>86</sup>Merrett (n 2) 24

<sup>87</sup>By social issues we mean matters that may affect directly or indirectly any member of a society or the stability of the general political set up.

<sup>88</sup>Bonner (n 6) 9-18

<sup>89</sup>Lawrence Black and Nicole Robertson(eds), *Consumerism and the Cooperative Movement in Modern British History: Taking Stock*(Manchester University Press, 2009) 69

<sup>90</sup>Merrett(n 2) 24

Some nineteenth and early twentieth century cooperative thinkers also had an intention of using cooperatives as more effective weapons in the working class struggle against capitalism and attaining a classless and democratic political order.<sup>91</sup> Cooperatives may also serve as an instrument to solve housing problems both in urban and rural areas.<sup>92</sup> They may also serve as a medium to subsidize the low income earners to reduce poverty.<sup>93</sup> Even some of those cooperatives established by colonial powers in Africa were intended to solve social problems by using economic activities as their entry gate. For example, the French Colonial Administrators were using cooperatives as a means to assimilate the Africans with the French culture and the Belgians were attempting to create paternalist relationship between the Belgium rulers and the Africans.<sup>94</sup> Even the British model of cooperatives in colonial Africa, which was intended to encourage white settlers to produce cash crops for export,<sup>95</sup> had a social objective of increasing and deepening white settlement. The transformation of the social life of rural communities was the main objective of cooperatives under the communist governments of the past.<sup>96</sup> The United Nations also sees cooperatives as good alternatives to reduce poverty and deepen grassroots democracies in developing countries.

In Ethiopia, cooperatives also have had social objectives since their inception in beginning of second half of 20<sup>th</sup> century. During the imperial era, cooperatives were thought, among other things, to promote modern farming (by serving as a demonstration place for farmers to learn the benefit of modern agricultural technology) and social justice (by improving income of members).<sup>97</sup> Removing the remnants of feudalism and semi-capitalism in the country throughout the country, especially in rural areas, were the ultimate objectives of cooperatives during the military regime.<sup>98</sup> Poverty reduction has been the central concern of cooperatives since 1990s.<sup>99</sup>

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<sup>91</sup> Ellen Furlough and Carl Strikwerda (eds), *Consumers against Capitalism? Consumer Cooperation in Europe, North America and Japan 1840-1940*(Rowman & Littlefield Publishers,1999) 116

<sup>92</sup> Ibid 43

<sup>93</sup> Ibid

<sup>94</sup> Frederick Wanyama, 'Reinventing the Wheel? African cooperatives in a liberalized economic environment' (2009) 80(3) *Annals of Public and Cooperative Economics* 361

<sup>95</sup> Ibid

<sup>96</sup> M Digby, *Cooperatives and Land Use* (Basil Blackwell, 1957) 61

<sup>97</sup> Cooperative Society Decree No. 44/1960 Art 3(e), 6, 14, 19 and 37 See also the preamble and Art 4 of the Cooperative Societies' Proclamation No.241/ 1966

<sup>98</sup> See the preamble of Cooperative Society Proclamation No.138/1978

The word ‘problem’ is also very important in the definition of cooperatives. The purpose of a cooperative is to solve the existing economic problems, social problems or to enable members to be able to achieve subsistence living; it is a matter of survival or self-preservation. In contrast, the economic purpose of an investor-owned firm is to enable members to have properties or wealth beyond what they normally need for survival. Its principal function is to expand private wealth rather than to produce goods people require for survival. In short, investor-owned firms are means of taking offensive (take more wealth from the market than members need for daily life) measures whereas cooperatives always take counter-offensive measures. The Cooperatives Society Proclamation No.147/1998 expects cooperatives to solve problems of members.<sup>100</sup>

#### **E. Democratic control**

Democratic control is one of the most important elements that apparently distinguish cooperatives from investor-owned firms. Democracy implies that everyone has equal decision making power regardless of other factors such as property. In investor-owned firms, the extent of participation in the management of the enterprise depends on the number of shares a member has in the share capital.<sup>101</sup> Democratic control or management is the expression of collective action/solution. Furthermore, democracy implies that individual members are more valuable to the ultimate objective of the cooperatives than their capital contributions. In short, in investor-owned firms capital decides, while in cooperatives individuals decide; investor-owned firms are associations of capitals whereas cooperatives are associations of individuals. Cooperatives Society Proclamation No.147/1998 not only includes this democratic control in the definition but also makes it a guiding principle of cooperatives and also expressly states that every member has only one vote regardless of the number of shares he/she has.<sup>102</sup>

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<sup>99</sup>The preamble and Art 3(6) of Agricultural Cooperative Society Proclamation No.85/1994 See also the preamble cum Art 2 cumulative Art 4 of Cooperative Society Proclamation No.147/1998. However; see our discussion in chapter seven to learn that the Ethiopian government has no public objective to attain through cooperative.

<sup>100</sup>Cooperatives Society Proclamation No.147/1998 Art 4

<sup>101</sup>See Commercial Code Art 407 and 534 For Ordinary Partnership the Commercial Code provides for democratic control unless other is provided in the partnership agreement. See Art 234 For other forms of partnerships (joint venture, general partnership and limited partnership) the code is silent and hence it is left to the partnership agreement and in the absence of the agreement the court may apply democratic rule for non-commercial partnership and share capital for commercial partnerships.

<sup>102</sup>Cooperative Society Proclamation No.147/1998 Art 5(2) and Art 18



However, the definition of cooperatives under the Cooperatives Law is silent about profit and loss sharing.<sup>103</sup> This may lead to two alternative interpretations: profit is not a concern of cooperatives or profit is the central concern of cooperatives. The latter interpretation, a radical and unexpected position, merges cooperatives with investor-owned firms.

The first is that profit is not the concern of cooperatives and hence they may even function at zero profit. This makes a cooperative a commission agent of its members (with the necessary changes having been made).<sup>104</sup> “In the absence of a stipulation in the contract, the agent shall not be entitled to remuneration unless he carried out the agency within the scope of his professional duties or where such remuneration is customary.”<sup>105</sup> Even where he is entitled to remuneration such remuneration may be fixed by agreement to a bare minimum.<sup>106</sup> Investor-owned firms do not represent shareholders in any sense. The relation is that of lender and borrower where the lenders expect interest and the borrower repay the loan with interest. Commercial loans are entered into when the borrower believes that he would earn a profit which exceeds the interest of the money he borrows thereby making profit and loss the core concept of investor-owned firms. Generally, since cooperatives are commission agents (cooperative buys or sells by its own name but on behalf and for the benefit of members) profit and loss is not an issue.

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<sup>103</sup> See Art 211 of the Commercial Code which expressly mentions profit or loss sharing as a core element in the definition of partnership agreement

<sup>104</sup> “The commission to buy or to sell is a contract of agency whereby the agent, called the commission agent, undertakes to buy or to sell in his own name but on behalf of another person, called the principal, goods, securities or other fungible things.” “Where the commission agent who is himself entitled to act as buyer or seller notifies the principal of the carrying out of a transaction without naming the person with whom he contracted, he shall be deemed to have assumed the obligations of buyer or seller on his own account”. (Emphasis added). See Art 2234(1) and 2249 of the Civil Code of the Empire of Ethiopia of 1960. Based on the relationship between members and the cooperatives, cooperatives can be classified into consumers’ cooperatives, producers’ cooperatives and workers cooperative. Consumers cooperatives are cooperatives which provides goods/service to members: cooperative is seller; members are buyers or consumers. Consumer cooperatives serve as buying commission agent. The sale may be either service including financial service or supply of goods of any type. Saving and credit cooperatives, housing cooperative, retailer cooperatives, and a suppliers cooperatives are examples. Producer cooperatives are those which serve their members as selling commission agent. The members are sellers to the cooperatives and the cooperatives purchase goods from members and sell to others by its own name but for the benefit of its members. Members of producer cooperatives are producers of primary products such as minerals, cereals, cash crops, fish etc. In Workers’ Cooperatives members are employees of the cooperative: cooperative is employer, members are employees but at the same time the cooperative also serves as a selling commission agent. Notice however; that the concept of commission agency would apply to cooperatives only if profit sharing is entirely dependent on the amount of goods purchased or offered for the sale or labour service supplied.

<sup>105</sup> Civil Code) Art 2220(1)

<sup>106</sup> Ibid Art 2234(2), 2220(1), 2243, 2244 and 2245

The second interpretation is that the law has made profit/loss a core element of cooperatives. This can be revealed from the Cooperative Society Proclamation No. 147/1998 Art 5(2), which lays down guiding principles of cooperatives and Art 33(2), which governs allocation of profit. The former, provides that profit shall be distributed proportionately to the share capital each member holds in the cooperatives thereby completely merging cooperatives with investor-owned firms, whereas the latter provision dictates that profit distribution has to take into account both the shareholding in the capital and use of the cooperatives services thereby creating a hybrid type of business enterprise (a mid between cooperatives and investor-owned firms). Furthermore, there is a possibility that a person who may not provide goods/service or may not purchase goods/services may have a shareholding in the cooperatives<sup>107</sup> implying profit and loss. The necessity of raising capital also indicates the possibility of profit/loss.<sup>108</sup>

### **3.3 Objectives of cooperatives**

The word objective may indicate a mission, goal or vision. Mission indicates the activities and the way of carrying out such activities. Goal is the problem that is to be solved by accomplishing the mission. Vision indicates the ultimate benefit expected of solving the problem. In other words, the mission of cooperatives is the collective engagement in economic activities. Their goal is to meet challenges that are difficult to do on an individual basis. Their vision is ascertaining economic and social justice. Whereas the mission of investor-owned firms is gathering money from capitalists and investing it, the goal is obtaining large amounts of capital and to maximize profit. Under this sub-topic, the word objective is used to refer to the mission and goal of cooperatives. Since the vision of cooperatives is a more general outcome and is either a matter of public policy, or ultimate objective that exist in the mind of cooperators and manifest itself in different ways, we may not find it in the law or in the by-laws of cooperatives. Thus the following discussion concerns only mission and goal and vision is discussed under chapter six *infra*.<sup>109</sup>

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<sup>107</sup> Cooperative Society Proclamation No. 147/1998 Art 16(6-7) as amended by Proclamation No 402/2004

<sup>108</sup> Ibid Art 16(1) and Art 10(2)

<sup>109</sup> Since the vision of investor-owned firms that is in the minds of the founders is known to everybody that it is profit making the law need not provide it expressly. Moreover; the founders do not usually mention it in a memorandum of association or articles of associations. Sometimes they would rather state public policy issues such as employment and import substitution as their own vision. The law does not also bother about the goal of investor-owned firms and

## **A. Mission of cooperatives**

Cooperatives have two missions, carrying out economic activities and encouraging collective actions. The first mission makes cooperatives similar with investor-owned firms and the second mission is to distinguish cooperatives from investor-owned firms.

The Cooperative Society Proclamation No.147/1998 provides that the mission of cooperatives is to carry out economic activities.<sup>110</sup> Some of these economic activities are agricultural, industrial, handicrafts, financial, fishery, mining and retailing.<sup>111</sup> Since the law lists these activities, one may also add education and health services into the list. Cooperatives could engage into any form of economic activities that are not expressly reserved to government only.<sup>112</sup> The intention of the law is not to limit cooperatives to certain types of economic activities but to emphasize that the mission of cooperatives can never be non-economic activities of whatever nature. By so doing, the law puts cooperatives in perfect equality with investor-owned firms, which is right.

However; in addition to carrying out economic activities, cooperatives are expected to encourage each member to be active in the process of economic activities either as a supplier, employee or purchaser (consumer of goods/service supplied by the cooperative) or in organizing collective action. In investor-owned firms, there is no need to organize individuals because there is no cause for collective action and ensuring members pay the agreed capital can be done with the support of regular courts. However, in cooperatives, it may not only be contrary to the law,<sup>113</sup> but also impractical to get the assistance of court to make members of the cooperatives carry out their obligations to collectively act in a certain manner. For example, in the case of producer (suppliers) cooperatives, the cooperatives become inoperative if members do not supply their product and members cannot be forced by the law to sell their products. Even if there might be a contract of supply, it may be terminated<sup>114</sup> or the member may not produce the intended product

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leaves the matter to the founders themselves. The founders mention their real goal and vision to the capitalists who are expected to become a member or a money lender.

<sup>110</sup>Cooperative Society Proclamation No.147/1998 Art 2(1) See also Art 4(9) which impliedly provides education and training as a mission of cooperatives.

<sup>111</sup>Ibid

<sup>112</sup>See Investment Proclamation No. 280/2002 Art 5(1&2) and Art 10(1d)

<sup>113</sup>In the normal course of things members of a cooperative may refuse to supply or purchase or work in the cooperative.

<sup>114</sup>Some cooperatives may provide in their bylaws that members shall always supply to or purchase from or work for the cooperatives. It is difficult to enforce such terms in the court of law in case the member has not produced anything or does not want the services/goods or does not want to work for. Since such bylaws are creating contracts

either intentionally or for reasons outside his control. Both cases would make the cooperative inoperative. The case would be even more serious in case of consumer and worker cooperatives. If members refuse to consume the goods/services of the cooperative, or workers show tardiness or terminate their employment contract, the cooperative becomes inoperative. Generally since collective action is the key element for the success of cooperatives, the good will and enthusiasm (moral and psychological element) of members and management committee are determinant of cooperatives success.

## **B. Goals of cooperatives**

The goal of cooperatives is withstanding challenges that are difficult on an individual basis.<sup>115</sup> The challenges may be economic, social or technological. Under the Cooperative Society Proclamation No. 147/1998, cooperatives are not entitled to have political or religious goals.<sup>116</sup> Article 31 of the Constitution of the Federal Democratic Republic of Ethiopia recognizes the right to freedom of association for any cause or purpose. However, the second paragraph of the same article further provides that this constitutional right has to be exercised only in accordance with the specific legislation governing the type of association.

The primary goal of cooperatives is to withstand economic challenges.<sup>117</sup> These challenges include shortage of resource, marginal cost of small scale production, risks and market failure. Cooperatives aim to help members to withstand these problems by enabling them to pool resources to benefit from economies of size and by distributing risks among

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for indefinite period the member may terminate at any time by giving default notice. See Art 1821 of the Civil Code of the Empire of Ethiopia of 1960

<sup>115</sup> See Cooperative Society Proclamation No.147/1998 Art 4

<sup>116</sup> Cooperatives may have politics or religion as their goal. For example in North America cooperatives among farmers were frequently connected with political activities.(See Merrett(n 2) 30). The British Cooperative Movement also established Central Cooperative Parliamentary Representation Committee in 1917. (See Bonner (n 53) 143) The Cooperative Societies established by Christian Socialist Movement in 1850s Britain had a religious goal of attaining order of mutual love and fellowship and to create a community that actually lives under Christ “in which no man has a right to call anything he has his own, but in which there is spiritual fellowship and practical cooperation” (Ibid p.61). Cooperative collectivization in communist countries had a political objective of transforming the community from feudal/capitalist culture to socialist culture.. There were also Socialist and Catholic Cooperative Societies in Italy. See Diarmid Coffey, *The Cooperative Movement in Yugoslavia, Rumania and North Italy*(Oxford University Press, 1922) 73

<sup>117</sup> David Cobia (ed),*Cooperatives in Agriculture*(Englewood Cliffs,1989) 122; and Cooperative Society Proclamation No.147/1998 Art 4(5)

themselves.<sup>118</sup>“Resource pooling could be made through contribution to the capital in the form of share or in the form of savings and credit.”<sup>119</sup>By pooling resources, cooperatives would enable members to benefit from technologies, such as trucks to transport their products or refrigerators for dairy products. Moreover, pooling of resources may lead to benefiting from economies of size. “The existence of economies of size up to some size, which is often larger than a typical proprietorship, encourages firms to expand horizontally.”<sup>120</sup>Since “fixed costs of management are spread over greater volume, larger machines use less labour per unit, larger storage structures cost less per unit of capacity, and so on.”<sup>121</sup>Economies of size are not limited to technologies only. It also helps members to access better markets for their products by using the cooperatives as either selling or buying commission agent.<sup>122</sup> By so doing members would successfully resist market monopoly and brokerage. They would also add value to their primary product. Generally cooperatives intend to improve the income of members either by reducing production or service costs or by finding better prices to their products or by distributing risks.<sup>123</sup>These economic benefits would be the goals of investor-owned firms although members of investor-owned firms never get access to the properties of their company.<sup>124</sup>

But what really distinguishes cooperatives from investor-owned firms, is the possibility of contributing labour as a major source of capital. In cooperatives, individuals can contribute their special knowledge to solve their economic problems, such as joblessness and lack of finance. For example, in housing cooperatives, members may contribute their labour to reduce the cost of production. In investor-owned firms, contribution of skill is not permitted except in the case of a partnership.<sup>125</sup> Even for partnerships, labour contribution is an exception. In short, cooperatives can mainly be a cooperation of labour, but investor-owned firms are mainly and necessarily a cooperation of capital. However, the Ethiopian Cooperatives Law does not make such distinction clear because it makes capital contribution a mandatory requirement for membership.<sup>126</sup>

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<sup>118</sup> See Cooperatives Law Art 4(1,2 &8)

<sup>119</sup> Ibid Art 16, 4(7) & 2(1e)

<sup>120</sup> Cobia (n 119) 122

<sup>121</sup> Ibid 125

<sup>122</sup> See our discussion supra note 104

<sup>123</sup> Cooperative Society Proclamation No. 147/1998 Art 4(4&5)

<sup>124</sup> Although in the Ordinary Partnership members could use the property of the partnership. See Commercial Code Art 245

<sup>125</sup> Ibid Art 229,295 and 303

<sup>126</sup> Detail about this issue is discussed infra on page 38-39

The second goal is dissemination of technology.<sup>127</sup> The economies of size and resource mobilization further help cooperatives to utilize modern technologies. In addition to improving the production and then the economy of members in particular and the country in general, technology can be developed within a cooperative. Cooperative can also become the bridge to import technology to the members and then to the general public.

The third major goal of cooperatives is addressing social issues.<sup>128</sup> Robert Owen had in his mind at least three major social goals to establish cooperative societies. These social goals were reducing poverty, persuading the public and politicians to do away with competition in general and market economy in particular and nurturing moral values.<sup>129</sup> The latter British Cooperative Movement concentrated very much on the protection of members against the capitalist market economy. Socialist Cooperative Societies of Western Europe had economic equality as their social goal.<sup>130</sup> Nineteenth century American farmer cooperatives had a social goal of representing the interest of farmers in the parliament.<sup>131</sup> Since the goal of the cooperative is defined by the cooperators within the limit of the law, cooperatives could have varied and specific social goals of their own.

The social goals of Ethiopian cooperatives are provided for in the Cooperative Society Proclamation No.147/1998. Cooperatives in Ethiopia can have the social goal of culturally transforming the whole society,<sup>132</sup> developing psychological self-reliance in the individuals mind<sup>133</sup> and protecting group interest.<sup>134</sup> Cultural transformation is intended to be attained by educating the masses and by making cooperatives exemplary examples to the people.<sup>135</sup> The success of cooperatives would build the individual and group psychology of “I or we can do it by my/ourselves.” Finally producers, employees or consumers could combine against their economic opponents.

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<sup>127</sup> Ibid Art 4(6)

<sup>128</sup> Cooperatives Society Proclamation No. 147/1998 Art 4(3,7&9)

<sup>129</sup> Bonner (n 53) 10

<sup>130</sup> See for example Coffey (n 118) 74

<sup>131</sup> Merrett (n 2) 31

<sup>132</sup> Cooperative Society Proclamation No.147/1998 Art 4(9)

<sup>133</sup> Ibid Art 4(3)

<sup>134</sup> Ibid Art 4(5)

<sup>135</sup> Ibid Art 4(7&9) For example credit and saving cooperatives could become a practical example to enhance the saving and loan culture of a society.

Finally, we need to notice that all the goals including the social goals seem to have been intended to enhance and protect economic interest. There is no clear indication that the law wants cooperatives to attain social transformation such as equality of sex, elimination of harmful traditional practices, crime prevention, and sanitation and so on as a goal in itself.

### **3.4 Formation and liability of cooperative**

Formation is a process that enables a cooperative to get legal personality. Legal personality entitles a cooperative to become subject to rights and duties. There are two major phases in this process. The first phase is the coming together of important components, that being the essence of a cooperative. These include membership, management and by-laws. The cooperative's name and the minutes of the founders' meeting, may also be included into this first phase. The second phase is the phase that makes the cooperative known to the public. Publicity is made through registration. Since registration exposes the cooperative to rights and liabilities, this subtopic examines formation and liabilities cooperatives. It concludes that the formation and liabilities of cooperatives circumscribe with the formation and liabilities of investor-owned firms.

#### **A. Essence of a cooperative**

The Ethiopian Cooperatives Law considers membership, by-laws, management, and name and minutes of founders' meeting as substantive elements that have to be fulfilled in order to establish a cooperative.

##### *Membership*

Cooperatives are associations of persons. Therefore, the existence of members is self-explanatory. Rather the most important points are number of members, and criteria for membership. Since there is principle of open membership, the requirements of membership provided by the law are exhaustive requirements. Additional requirements that may make admission into a cooperative more difficult may not be introduced by the founders' meeting or by the by-laws or general meeting. Membership in a cooperative is not the result of partnership agreement.

The minimum number of members in a primary cooperative is ten.<sup>136</sup> The minimum number of members in secondary cooperatives is not determined by the law but by definition it should be at least two. The maximum number is normally indefinite due to the principle of open membership. The minimum and maximum number of members in investor-owned firms is dependent on the type of investor-owned firms. The minimum number for partnership and private limited company is two.<sup>137</sup> A minimum of five persons are required to establish a share company.<sup>138</sup> The maximum number of members is indefinite for partnerships and Share Company.<sup>139</sup> But private limited company may not have members exceeding fifty.<sup>140</sup> Since there is no principle of open membership in investor-owned firms, the maximum number of members may be defined in memorandum of association or articles of association.

There are criteria that a person has to fulfill to become a member of a cooperative. These criteria are legal, financial ability and ethical reputation.<sup>141</sup> Locality and collective objectives (are also indispensable requirements.<sup>142</sup> However, these criteria are equally indispensable for investor-owned firms also. Proof of legal personality is necessary for artificial (primary cooperatives that want to be a member of union/federation/league).<sup>143</sup> Legal personality of human is irrefutably presumed.<sup>144</sup> Human beings are subject of right and duties from moment of birth to death and such is recognized everywhere.<sup>145</sup> A physical person can become a member of a cooperative only if she attains the age of 14.<sup>146</sup> There is no express age limitation for membership in investor-owned firms although a minor is prohibited to carry out any trade.<sup>147</sup>

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<sup>136</sup>The Cooperative Society Proclamation No.147/1998 Art 6(3&4)

<sup>137</sup>Commercial Code Art 211 and 510(2)

<sup>138</sup> Ibid Art 307(1)

<sup>139</sup> Ibid Art 211 and 307

<sup>140</sup> Ibid Art 510(2)

<sup>141</sup> Cooperative Society Proclamation No.147/1998 Art 13

<sup>142</sup> Ibid Art 6(2) and 2(2)

<sup>143</sup> Ibid Art 13(5)

<sup>144</sup> FDRE Constitution Art 24(3)

<sup>145</sup> Civil Code Art 1. Although; there may be restriction on rights or exercise of rights the burden of proof is on a party who alleges such restrictions. See Civil Code Art 192-196

<sup>146</sup> Cooperative Society Proclamation No.147/1998 Art 13(1)

<sup>147</sup> Commercial Code Art 11-14



The other important point for membership is financial ability.<sup>148</sup> A person who wants to join a cooperative has to agree to contribute a certain amount of money to the capital of the cooperatives. He has to also pay at least a quarter of this money before he is recognized as a member.<sup>149</sup> When we compare this with investor-owned firms in Ethiopia, cooperatives are closer to investor-owned firms than partnerships. It is only in private limited companies and share companies, that contribution of skill is not recognized. In partnerships, a member can contribute his skill,<sup>150</sup> but that does not seem possible under cooperatives since the cooperatives raise capital for starting the business<sup>151</sup> which probably excludes skill. Still more, since a payment of a quarter of the share capital before getting membership also excludes the possibility of labour to be contributed.<sup>152</sup> Financial ability may even be more challenging for membership in a cooperative than in company form of investor-owned firms. This is because the Ethiopian Cooperatives Law leaves the minimum capital to be determined by the founders' meeting.<sup>153</sup> This meeting may fix 'big' capital and divide it into shares of equal number and par value. Poor individuals may, therefore, be intentionally excluded from membership. Moreover, the general meeting may, at any time after the formation of the cooperative, increase the capital of the cooperative and require the members to increase their share capital.<sup>154</sup> A member who is unable to purchase new shares may be dismissed from membership for failure to obey the decision of the cooperative.<sup>155</sup> In investor-owned firms no member is required to increase her share capital without her consent and no member can lose her membership for failure to contribute to the increment of capital.<sup>156</sup>

Ethical reputation is another requirement for membership. Under Ethiopian Cooperative Law, this requirement may be inferred from four different points. The first is dismissal of a member for repeated fault. A member could be dismissed from membership due to repeated faults.<sup>157</sup> This may be taken to imply that this measure may even be taken before a person becomes a member-refusal to admit. Preventive measures are better than curative. The second point is the need of the

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<sup>148</sup> Cooperative Society Proclamation No.147/1998 Art 13(2)

<sup>149</sup> Ibid Art 16(2) as amended by Proclamation 402/2004

<sup>150</sup> Commercial Code Art 229, 295 & 303

<sup>151</sup> Cooperative Society Proclamation No.147/1998 Art 16(1) as amended by Proclamation 402/2004

<sup>152</sup> Ibid Art 16(1&2)

<sup>153</sup> Ibid Art 16 (1&2)

<sup>154</sup> Ibid Art 16(3)

<sup>155</sup> Ibid Art 14(2a), cum 15(2)

<sup>156</sup> See Commercial Code Art 233(2), 295, 303, 425(2b) and 536(2)

<sup>157</sup> Cooperative Society Proclamation No.147/1998 Art 15(2)

decision of the general meeting to admit heirs as members.<sup>158</sup> Having in mind the principle of open membership the general meeting discusses nothing but the ethical reputation of the applicant. The third point is the requirement of ‘willingness.’ According to Art 13(2) of Cooperative Society Proclamation No.147/1998, any individual may become a member of a cooperative where he is willing to implement his obligation, and to observe the objectives and by-laws of the cooperative. It may not be taken to mean only the individual’s declaration to be bound since such declaration can be clearly inferred from his mere application to become a member.

Locality is also a requirement for membership in primary cooperatives.<sup>159</sup> Members of cooperatives should be residing in the same locality. This is because producer and consumer cooperatives are associations of individuals who are collectively searching for an alternative market. Producers bring their product together for collective supply. If members are living long distances from each other, it is costly to bring their products together. Consumer cooperatives distribute goods and services to members. Such a distribution is to be difficult and uneconomical where members are living far apart from each other. Worker cooperatives are also feasible only if members are living in the same locality, since it is difficult to determine a convenient work place for all members. In addition to the issue of economic feasibility, locality is also important to strengthen the solidarity between members. Social solidarity is one of the goals of cooperatives. However, Ethiopian Cooperatives Law opens room for violation of locality requirement since it allows the sale of shares to persons living outside the local area of the cooperative.<sup>160</sup> Membership in investor-owned firms, do not require locality since investor-owned firm is mainly the association of money. It does not also have social objective of social solidarity.

### *By-Laws*

By-laws perform the same role for cooperatives as Articles of Association do for investor-owned firms. Articles of Association and other resolutions and agreements may collectively called

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<sup>158</sup> Ibid Art 19(3)

<sup>159</sup> Ibid Art 6(2)

<sup>160</sup> Ibid Art 6(5)

Constitution of investor-owned firms.<sup>161</sup> Thus by-laws may be called the constitution of a cooperative.

Memorandum of Association is a contract that governs the relationship between the shareholders (investor capitalists) and creditors of the investor-owned firms and the investor-owned firm and its creditors. It indicates persons who would be responsible for the business risk, extent of such responsibility and the name of persons through which the investor capitalists are acting. This is evident from that fact that it contains the name and address of the investor-owned firm, the name (including address) of members and amount of capital contribution of each member, the names of the agents and extent of that agency (management organs including auditors in case of companies), business purposes (indicators of extent of the power of representation) and profit sharing (this is an important information for third parties to deal with the investor-owned firm).<sup>162</sup> Articles of Association are supplementary and subordinate to Memorandum of Association.<sup>163</sup> They are contractual terms that govern the relationship between the shareholders and the investor-owned firms and shareholders and management.<sup>164</sup> The relationship between shareholders and the management may be equated to an agency contract which governs the relationship between the principal and the agent.

Under the Ethiopian Commercial Code only Share Companies and Private Limited Companies are expressly required to have Articles of Association in addition to Memorandum of Association although partnerships could also draw their own Articles of Association.<sup>165</sup> However, Memorandum of Association is an essential requirement for all investor-owned firms.

Like a partnership, Ethiopian cooperatives law does not require cooperatives to have Articles of Association. However, the close examination of the content of the by-laws implies that the by-laws governs not only the relationship of the members of the cooperatives with creditors of the cooperatives and cooperatives with its creditors it also governs the relationship between members and the cooperatives and members and the management. This is inferred from the fact that the by-laws has to contain the name & address of the cooperative, the name (including

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<sup>161</sup> UK Companies Act 2006 section 17

<sup>162</sup> Commercial Code Art 284, 298, 313 and 517

<sup>163</sup> Ibid Art 314 & 518

<sup>164</sup> Ibid; See also Talbot *Critical Company Law* (Routledge 2008) 63 and 77

<sup>165</sup> Commercial Code Art 314 & 518

address) of members and amount of capital contribution of each member, name of agents and extent of the agency business purposes and profit sharing.<sup>166</sup> Besides it has to contain rights and duties of members, criteria for membership, and conditions for withdrawal and dismissal from membership.<sup>167</sup>

### *Name of the cooperative*

An organizations name is an attribute of legal personality. There is plurality of legal persons. As a result, it is difficult to imagine rights and duties of a legal person without a name given to that legal person. The name serves as a means of distinguishing one legal person from other similar legal persons. Physical persons have family name, first name and patronymic name.<sup>168</sup> State and its Administrative Organs, Political Parties, Charities & Societies, Public Enterprises, and investor-owned firms also have a name that distinguishes them from other similar legal persons. Similarly a cooperative also has a name that distinguishes it from other cooperatives.<sup>169</sup>

In the case of investor-owned firms, in addition to distinguishing it from similar legal persons, the name also shows the extent of liability. The name of a share company should include the phrase “share company.”<sup>170</sup> A share company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company.”<sup>171</sup> Members are liable only to the extent of their shareholding.<sup>172</sup> Similarly the name of Private Limited Company has to contain the phrase ‘Private Limited Company.’<sup>173</sup> Members of Private Limited Company are liable only to the extent of their contribution.<sup>174</sup> In a partnership, the name has to indicate whether the partnership is general or limited.<sup>175</sup> In a general partnership, all members are joint guarantors of the debt of the partnership.<sup>176</sup> In a limited partnership, some members are liable only to the extent of their contributions.<sup>177</sup> The name of the partnership also indicates the

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<sup>166</sup> See Cooperative Society Proclamation No.147/1998 Art 11 (1&2)

<sup>167</sup> Ibid Art 11(2)(e), 2(f) and 2(g)

<sup>168</sup> Civil Code Art 32

<sup>169</sup> Cooperative Society Proclamation No.147/1998 Art 8(2)

<sup>170</sup> Commercial Code Art 305

<sup>171</sup> Ibid Art 304(1)

<sup>172</sup> Ibid Art 304(2)

<sup>173</sup> Ibid Art 514(2)

<sup>174</sup> Ibid 510(1)

<sup>175</sup> Ibid Art 281 and 297

<sup>176</sup> Ibid Art 280

<sup>177</sup> Ibid Art 296

partners who guarantee the debt of the partnership.<sup>178</sup> The name of a cooperative plays exactly the same role as the name of investor owned firms. It has to contain the phrase ‘Cooperative Society and Limited Liability.’<sup>179</sup> A cooperative is not liable beyond its total asset.<sup>180</sup> Members are liable only to the extent of their contribution. The inclusion of the phrase ‘Cooperative Society’ in the name also conveys some message to third parties about the liability of cooperatives.

### *Minute of founders’ meetings*

Membership, by-laws, management and name may be taken as the physical organs of human being. Whereas, minute of founder meeting breathes life into the physical body, so that it could have soul like God gives life to human beings. Soul is the essence of personality. Founders’ meeting is the decision of members to breathe life into physical organ so that it becomes legal person. Minutes of founders’ meeting may also be equated to declaration of willingness (consent) of members to be bound by the by-laws. In partnerships and Private Limited Companies, the law does not require special form of expression of willingness to be bound.<sup>181</sup> It is enough if the members sign the memorandum association and/or articles of association.<sup>182</sup> However, like cooperatives, share companies are required to have minute of founders’ meeting.<sup>183</sup>

## **B. Registration**

Registration is equivalent to birth. Birth is the beginning for legal personality for physical person.<sup>184</sup> Likewise registration is the beginning of legal personality for cooperatives.<sup>185</sup> The same is true for investor-owned firm as well.<sup>186</sup>

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<sup>178</sup> Ibid Art 281 and 297

<sup>179</sup> Cooperative Society Proclamation No. 147/1998 Art 8(2)

<sup>180</sup> Ibid Art 10(2)

<sup>181</sup> See Civil Code Art 1681, Commercial Code Art 221(2), and Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 6(7) and 11(1)b)

<sup>182</sup> Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 6(7)

<sup>183</sup> Ibid 12(1(c)

<sup>184</sup> Civil Code Art 1

<sup>185</sup> Ethiopian Cooperatives Law Art 10(2)

<sup>186</sup> Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 9(1)

Before registering cooperatives, the Commission,<sup>187</sup> the federal Government organ that registers cooperatives in the federal level, has to ensure that substantive components are fulfilled.<sup>188</sup> The Commission also requests the work plan and description of the land on which the cooperative intend to operate.<sup>189</sup> Although investor-owned firms are not required to produce their work plan, they are required to produce authenticated document that shows their working premises.<sup>190</sup> Once the cooperative is registered it becomes a legal entity from the moment of its registration.

### **C. Limited liability**

Registered cooperatives have legal personality. This means the existence of cooperatives is distinct from its members. Legal personality by definition implies rights and duties. Cooperatives enter into contract and own property. This implies that they may have contractual and/or extra-contractual liabilities. They have to meet these liabilities by their own assets and claims. This means the members are not liable to the debts of the cooperatives. There are no legally recognized relationships between creditors of the cooperatives and its members. The creditors of the cooperatives can claim against the members only on behalf of, and by the name of, the cooperatives. This is also true for shareholders of companies. This is the concept of limited liability.

Like companies cooperatives have limited liabilities but unlike companies there is no minimum capital fixed by the law. Capital is a security to creditor. Cooperatives are free to determine the amount of such security. Share Company shall have a minimum capital of fifty thousand birr.<sup>191</sup> Private Limited Company's shall have a minimum capital of fifteen thousand birr.<sup>192</sup> Furthermore, unlike a company there is no clear indication in cooperatives law about the liability of founders and management organs to creditors of a cooperative.<sup>193</sup> Still more, unlike

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<sup>187</sup> The Federal Cooperative Commission (Commission) is a federal organ established in 2002 with the objective of promoting and registering cooperative that can be established in the federal level. See Proclamation 274/2002

<sup>188</sup> See Cooperative Society Proclamation Art 9(2)

<sup>189</sup> Ibid Art 9(2)(g) and (2)(j)

<sup>190</sup> Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 10(7), 11(1(e), and 12(1(f)

<sup>191</sup> Ibid Art 306(1) Currently one pound is about thirty one birr or one Dollar is about twenty birr. This means fifty thousand birr is about one thousand six hundred pound or two thousand five hundred dollar. Exchange rate varies on daily basis.

<sup>192</sup> Ibid Art 512(1)

<sup>193</sup> Ibid Art 309, 366, 380 and 530

companies in cooperative there is no requirement of verification of valuation of contribution in kind.<sup>194</sup> These differences could even be taken as special privileges of cooperatives.

### **3.5 Conclusion**

In Chapter One we have seen that cooperators are pushing cooperatives from cooperation and social objective model into the realm of investor owned firms (partnership/company)-competition and profit-maximizing model. Similarly in Chapter Two we have also seen that cooperative form of economic organization may serve the competition and profit-maximizing model.

In this Chapter we have examined whether the legislator have conceptually limited cooperatives to cooperation and social objective model. However; we have found out that the legislator have failed to distinguish cooperative form of economic organization from investor owned firms thereby opening a wider room for cooperative form of economic organization to be utilized for competition and profit-maximization purposes.

This is evidenced from the legal recognition of special privileges to cooperatives only. The special privilege apparently seem to distinguish cooperatives from investor owned firms but when critically examined would reveal that it opens a wider room for entrepreneurs to prefer the cooperative form of economic organization to benefit from the special privileges unless there is a clear legal mechanism that bars investors to move into cooperatives. The special privileges such as freedom from attachment for debts, income tax exemptions and government such as easy access to loan and land grant are in fact very tempting benefits.

Moreover, in addition to the absence of concept of philanthropy and not-for-profit motives in the definition of cooperatives the legal inclusion of capital contribution as a mandatory membership criterion indicates the failure of the law to distinguish cooperatives from investor owned firms. Still more, the content of the by-laws is mainly left to the decision of the founders' meeting or general meeting as it is generally the case in investor owned firms. The similarity between the liabilities of cooperatives with the liabilities of investor-owned firms further exacerbated the problem.

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<sup>194</sup> Ibid Art 315 and 517(f)

Although the law includes the concept of collective solution to a collective problem in the definition of cooperatives and also provided mission and goal of cooperatives, such is insufficient to keep entrepreneurs away from cooperative form of economic organization. The mission of cooperatives is carrying out economic activities since such activities are not limited to certain sector of the economic activities and do not implicate the role of the members of the cooperative in the economic activities.

The next Chapter examines whether the Cooperative Principles recognized by the law is capable of distinguishing cooperatives from investors.



# **CHAPTER FOUR**

## **COOPERATIVE PRINCIPLES UNDER ETHIOPIAN COOPERATIVE LAW**

### **4.0 Introduction**

The purpose of this chapter is to show that the cooperatives principles under Cooperative Societies Proclamation No.147/1998 do not sufficiently distinguish cooperatives from investor-owned firms. This is because the principle of open membership is not recognized and the principle of user ownership, user control and user benefit is impliedly excluded by the principle of distribution of profit on the basis of share capital. Moreover; the distribution of profit on the basis of capital contribution can make almost other cooperative principles ineffective and dull. This is because profit distribution on the basis of capital invites investors into the cooperatives who may use all possible means such as lobbying to neutralize the actual effect of other principles such as democratic control.

In Ethiopian Cooperative Law, the Cooperative Society Proclamation No.147/1998 prescribes the missions and goals of cooperatives. It has also laid down cooperative principles/ethics that would help guide them. Cooperative principles are rules which the cooperative has to observe in all its activities if it is to attain its goals.<sup>1</sup>A change of cooperative principles would mean a change in the cooperative goal.<sup>2</sup>Furthermore, many people believe that cooperatives could operate effectively in a capitalist market economy if only their principles were properly understood.<sup>3</sup> Cooperative principles are the means to an end.<sup>4</sup> Cooperative principles are what distinguish cooperatives from other forms of businesses such as investor-owned firms.<sup>5</sup>Investor-owned firms do not have guiding principles to attain their goals. This is because they do not have

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<sup>1</sup> Arnold Bonner British Cooperation The History, Principle and Organization of the British Cooperative Movement (Co-operative Union Ltd, 1961)292

<sup>2</sup> Ibid

<sup>3</sup> Cobia, W, David (ed.) Cooperatives in Agriculture 1989 (Prentice Hall.inc. 1989) 21

<sup>4</sup> Ibid p. 26 See also objectives of cooperatives in chapter one and chapter three above

<sup>5</sup> Ibid

a common societal goal that they aim to meet and each investor-owned firm is free to attain its own goals through its own business purposes.<sup>6</sup>

However; although the Ethiopian Cooperatives Law apparently mainly adheres to the Contemporary School of cooperative principles<sup>7</sup>; the critical examination the law reveals that they are modified to push cooperatives into investor owned firms and hence could not guide cooperatives in the direction of cooperation and social objectives. This chapter examines the extent of the modification of these principles and the possible implication of such modification on the distinction between cooperatives and investor owned firms.

## 4.1 Voluntariness

As we discussed under definition of cooperatives<sup>8</sup>, voluntariness mean two things: firstly, free and unrestrained will of a person to be bound by an obligation and secondly; commitment to carry out certain obligations without consideration or with insignificant consideration. Let us make some detailed examination of these two concepts of voluntariness one after another.

Voluntariness in its first sense is equivalent to consent. This is for three major reasons. The first reason is that it is possible to argue that an agreement to form a cooperative(minute of founders' meeting)<sup>9</sup> is a contract among the persons agreed to form the cooperative(cooperators/founders)

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<sup>6</sup> However; this by no way means that there is no common business ethics for investor-owned firms to operate. For example there is business ethics of trust, good faith and corporate social responsibility.

<sup>7</sup>See Cooperative Society Proclamation No.147/1998 Art 5. There exist significant disagreements as to what constitutes a correct set of cooperative principles (Cobia supra note 3. P.21) There are four major schools of cooperative principles; namely the Rochdale, Traditional, Proportionate and Contemporary Schools.(Ibid) .(Notice that some literatures do not mention proportional and contemporary schools; they rather substitute these schools by 20<sup>th</sup> Century and ICA principles,. It seems that the discrepancy arises from the fact that the former author has excluded the ICA principles from the list whereas the latter fails to mention the contemporary (cooperative principles that emerged after 1980s. The principles are divided along the property rights specification for ownership, control, distribution and derivation of benefits and others. The Rochdale class was developed and widely practiced in the nineteenth century and its central tenets were voluntariness, open membership, democratic control, cooperation and education. The traditional school was developed and widely practiced in the 20<sup>th</sup> c and is almost the same with Rochdale schools. The proportional has been introduced in the 20<sup>th</sup> c to bring cooperative more closely to investor-owned firms so that they could be effective in market economy but never become popular. The Contemporary schools are implied or express restatement of essential elements of traditional principles and most cooperative leaders adhere to traditional principles. (See Christopher Merrett and Norman Walzer (eds.) Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century 2004( M.E. Sharpe. Inc. 2004 ) 59-64

<sup>8</sup> See supra pp.60-62

<sup>9</sup>According to Art 9(2(a) of the Cooperative Society Proclamation No. 147/1998 those who signed the minutes that establish the cooperative are called founders.

as an agreement to form investor-owned firm is a contract among the members/shareholders (founders).<sup>10</sup> A contract is an agreement that involves an obligation of a proprietary nature.<sup>11</sup> Membership to a cooperative imposes obligation of proprietary nature either in the form of capital contribution or at least ways of sharing of surplus. Consent is a central idea of contract. Secondly, since the Cooperative Society Proclamation No.147/1998 does not contain a definition of voluntariness contract law provisions that talk about consents may be utilized to understand voluntariness.<sup>12</sup> Thirdly, even if the minute of the founders' meeting is not a contract it can still be maintained that voluntariness is equivalent to consent since like consent, voluntariness is an expression of intention to be bound by an obligation. So for these three reasons the concept of consent could be utilized to elaborate voluntariness.

Consent is the most crucial element for validity of contract.<sup>13</sup> A person is said to have agreed to be a member of a cooperative if they have given their consent after realizing that such consent would produce legal consequences,<sup>14</sup> since sometimes a person may sign a document simply to indicate he positively sees the establishment of cooperatives.<sup>15</sup> Furthermore, there should not be any defect in consent such as mistake, fraud, duress and false statements.<sup>16</sup> These matters are about unnecessary interference by individual persons in the freedom of choice of the person who is to be a member. Such defects in consent are practically less important.

The second limb of the principle of voluntariness is that of assisting each other.<sup>17</sup> In addition to lending a hand to a needy member, this concept also implies that each member has to convince themselves that they carry out their obligation with full responsibility. A member should not

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<sup>10</sup>The Commercial Code Art 210 states that investor-owned firms are results of partnership and Art 211 defines partnership as a contract. According to Art 307 in public (share) company founders are persons who sign the memorandum of association and subscribe the whole of the capital or persons who sign the prospectus, bring in contributions in kind or are to be allocated a special share in the profits including non-members who has initiated plans or facilitated the formation of the company. Partnership agreement is the sum total of memorandum of association and articles of association. The minute of the founders' meeting of the cooperatives is equivalent to memorandum and by-laws are equivalent to articles of association. See also Commercial Code Art 221(2), 313, 314, 516, 517 and 518 and Commercial Registration and Business Licensing Proclamation No. 686/2010 Art 11(1b) and 12(1d)

<sup>11</sup> See Civil Code Art 1675

<sup>12</sup> Ibid Art 1677

<sup>13</sup> Ibid Art 1678(a)

<sup>14</sup> Ibid Art 1679

<sup>15</sup> Ibid Art 1687

<sup>16</sup> Ibid Art 1696-1710

<sup>17</sup> See supra p.4

expect someone to direct or remind him to carry out his obligations and activities, necessary for the promotion of the cooperatives. Although there is a management committee to carry out certain management activities members should carry out their obligation out of being self-motivated and guided by a moral code. The earnest cooperator “believes that in working for the common good man’s highest qualities are enlisted and developed; and in the employment of these qualities the man himself becomes a better man and the quality of the human race is improved.”<sup>18</sup> Investor-owned firms rely on the contract, and the legal system, to make members/shareholders carry out their obligations. The strength of the judiciary in particular and the legal system in general, is the guarantee for the investor-owned firms to ensure that members/shareholders pay the subscribed capital. Likewise members/shareholders also rely on the contract and the legal system, to be sure that they would get the fruit of their investment. But in cooperatives the members depend mainly on the voluntariness of members to diligently, honestly and efficiently carryout their obligation. Members of cooperatives are expected to carry out their legal obligations and to go further. Thus, in general the principle of voluntariness indicates that members agree to whole heartedly carry out their obligations which includes legal and moral obligation. This means voluntariness of members in cooperatives exists both during formation of the cooperatives and during its continuation but investor-owned firms need voluntariness of members/shareholders only during formation.

However, the Cooperative Society Proclamation No.147/1998 Art 5(1) does not make any reference to members’ declaration of willingness for self- regulation. The only provision that seems to imply the existence of voluntariness is the dispute settlement mechanism.<sup>19</sup> Even these Articles may be taken as an indication of state interest to control cooperatives, rather than imposing a moral obligation on a member. There are no other provisions in the law that clearly expects members to take moral responsibility to carry out their obligations and to support the cooperatives. Generally, since Ethiopian Cooperatives Law obviously emphasizes the law, more than the moral commitment of the members to enforce member obligations, it merges cooperatives with investor-owned firms. It should have at least opened a room for a court to read moral obligations into the obligation of the cooperator. In general the nature of cooperatives membership involves higher levels of duties but the Ethiopian Cooperative Law has failed to

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<sup>18</sup> Bonner (n 1) 293

<sup>19</sup> See Cooperative Society Proclamation No.147/1998 Art 46-52

emphasis such duties. Such failure may be interpreted to limit the meaning of voluntariness to the contractual concept of defect free consent and undermines the member's duty of self-regulation. Cooperatives without members self-regulation is either dysfunctional or equivalent to investor owned firm.

## 4.2 Open Membership

Open membership means everybody that can use the services of the cooperative and voluntary to become a member, can become a cooperative on formation, or when already established, without any need to get the consent of the other members (at the general meeting of the cooperative).<sup>20</sup> Bonner argues that, "without this principle cooperatives would lose their cooperative character and degenerate into a profit-making concern."<sup>21</sup> Consumer cooperatives may limit membership and make profit from the purchases of non-members. Worker cooperatives may also employ large numbers of non-members and make profit from their labour.<sup>22</sup> Producer cooperatives (selling agents of individual producers of goods and even sometimes their labour such as supplying security guards and maidservants) may sell products from the labours of non-members and make profit thereof. The original cooperators like Owen

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<sup>20</sup>Notice that principle of open membership is more that non-discrimination on the basis of religion, political opinion, race, ethnic origin, colour, sex, language, disability or other similar status. Even investor-owned firms are prohibited from discriminating peoples on the above grounds; or else they end up perpetuating Hitlerism or apartheid. Therefore; when a public (share) company is established by public subscription as indicated on Art 317 of the Commercial Code any person who fulfill the requirement under Art 319 of the same code is automatically entitled to be a member/shareholder. Similarly investor-owned firms are entitled to choose their customer only on the basis of the price the customer offers to buy or use their goods/services. Article 25 of the Constitution of the Federal Democratic Republic of Ethiopian which prohibits discrimination on the basis of religion, political opinion, race, ethnic origin, colour, sex, language, disability or other similar status, applies not only to the government but also to individuals and all forms of associations. Probably the reason why Art 5(1) the last limb expressly repeats the constitution is only a cautionary remark against discrimination by cooperatives (not in any way impliedly allowing investor-owned firms to discriminate) since there has been practical experience that cooperatives may be established by members of the same religion/culture in order to create a religious/cultural community of their own. For example the in the British South Africa only white settlers were allowed to become members of cooperatives (See Wanyama, O Fredrick Supra Note No.45 p.361-392). There were also cooperative societies in North America which were established on the basis of ethnicity, occupation and socialist politics. ( Merrett, Christopher and Walzer, Norman (eds.) Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century( M.E. Sharpe. Inc. 2004 ) 29 There were also Christian Cooperatives in Europe such as in Italy (See Coffey, Diarmid, The Cooperative Movement in Jugoslavia, Rumania and North Italy 1922 p. 73). The *Kibbutz* of Israel was also open only to Israel-born individuals.(see Margaret Digby Cooperatives and Land Use (FAO Agricultural Development Paper 61, Food and Agricultural Organization of the United Nations, 1957) 28

<sup>21</sup> Bonner (n 1)296

<sup>22</sup> Ibid

believed that profit was derived from stealing of the labour of others.<sup>23</sup> Open membership is a remedy to such problem. Moreover, open membership keeps the cooperatives' capital unlimited since new members are required to take up shares.<sup>24</sup> New shares are taken at the original par value and the value of share never rises above their par value and there are no capital gains or speculations in cooperative shares.<sup>25</sup> Cooperatives are not therefore "composed of persons whose primary aim is to make gains from other persons."<sup>26</sup> Therefore, cooperatives that do not strictly adhere to the principle of open membership are often pseudo-cooperatives.<sup>27</sup> Pseudo-cooperatives are economic organizations that overtly appear to be cooperative but have a hidden agenda of competition and profit-maximization.

However, membership may be closed for justified reasons.<sup>28</sup> For example, economies of size may be a justified reason for limiting membership to a certain size. If a cooperative becomes too large, management efficiency declines and the cooperative may be less innovative and less flexible and unable to compete in a free market economy. More importantly, in cooperatives individual ethical discipline is very important and this may be best if members know each other so that they control each other. Membership also needs to be closed when the cooperative is a collective farm on a specified land size since the land may be unable to support persons beyond a certain limit. When cooperatives are available in all localities, locality may be a justified reason to refuse admission into membership. Finally the ethical discipline of the person applying for

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<sup>23</sup>For example Robert Owen believes that profit is stealing of the labour of others. See Bonner supra note 1 p.13-14. However; there are New Generation Cooperatives (NGC) which are established to maximize the profit margin of members.(Fairbairn, Brett , (n.2) 64). It is believed that such NGC should be organized under ordinary company law. (See Surridge and Digby A Manual of Cooperative Law and Practice ( 3<sup>rd</sup> edn Hefer & Sons LTD 1967 ) 5

<sup>24</sup> Ibid

<sup>25</sup> Ibid

<sup>26</sup>J.B. Surridge and Margaret Digby A Manual of Cooperative Law and Practice ( 3<sup>rd</sup> edn Hefer&Sons LTD 1967 ) 5

<sup>27</sup> Ibid

<sup>28</sup>Notice that Owen's village of cooperative community would have consisted of about thousand persons. See Bonner supra note 1 P.14 Notice also that cooperatives which are called New Generation Cooperatives restrict membership to the point where the greatest net profit and best chances for success can be attained.( Merrett, Christopher and Walzer, Norman Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century (( M.E. Sharpe. Inc. 2004 ) 64). However; pure and democratic cooperatives limit membership to keep cost to the minimum not to maximize profit.

admission may bar him from membership. In short, the principle of open membership intends to eliminate profit and capital gain<sup>29</sup> but does not intend to hinder the efficiency of cooperatives.

However, Ethiopian law is vague on principle of open membership. Firstly, the FDRE constitution does not recognize open membership in cooperatives. There is no constitutional guarantee of open membership in investor-owned firms, charities,<sup>30</sup> as well as cooperative societies<sup>31</sup> although there is recognition of open membership in political organizations, labour unions, trade organization, employers' associations and professional associations (societies).<sup>32</sup>

Secondly, the Cooperative Society Proclamation No. 147/1998 has subsided the principle of open membership under the principle of voluntariness. The law states seven guiding principles under seven consecutive and independent sub articles but principle of open membership is stated under a sub-article that mainly talk about principle of voluntariness.<sup>33</sup>

Thirdly, the limitation of capital in cooperatives absolutely blocks admission of new members. The general meeting decides the capital and the number of shares to be sold.<sup>34</sup> This in fact sounds quite clear, it doesn't allow open membership. This means the general meeting may limit the number of members of the cooperatives. Additional shares shall be sold only when there is a need for additional capital<sup>35</sup>

Fourthly, the necessity of paying share capital within four years in general and the mandatory payment of at least one-fifth of the capital and registration fees before getting recognition as a member<sup>36</sup> exclude the poor from membership. There are three methods by which cooperatives may raise capital. These are direct investment, retained dividend and deduction from the price of

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<sup>29</sup> Sidney & Beatrice Webbs The Consumers' Cooperative Movement (Longmans, Green and Co. 1921) 8-9

<sup>30</sup> Charities are institutions which are established exclusively for the benefit of indefinite persons composing the public or some part of the public with out exclusion of those in need.( Charities and Societies Proclamation No. 621/2009 Art 14)

<sup>31</sup> Cooperative Society Proclamation No.147/1998 Art 5(1) and FDRE Constitution Art 38(2)

<sup>32</sup> Societies are associations of persons organized on non-profit making and voluntary basis for the promotion of rights of its members and to undertake other similar lawful purposes as well as to coordinate with institutions of similar objectives.( Charities and Societies Proclamation No. 621/2009 Art 55(2)

<sup>33</sup> See Cooperative Society Proclamation No.147/1998 Art 5

<sup>34</sup> Ibid Art 6(2&4) and Art 16(1) as amended by Proclamation No. 402/2004. However; one may say that the former article implies that in principle the maximum number of member is indefinite and the latter article implies the number of share each member shall buy and its par value and has nothing to do with number of members.

<sup>35</sup> Ibid Art 16(3) .This may also be interpreted to imply only economies of size where there is economic down turn after certain large size.

<sup>36</sup> Cooperative Society Proclamation No.147/1998 Art 13(2), 14(2c), and 16(1&2) as amended by Proclamation No.402/2004

products supplied to the cooperatives.<sup>37</sup> Since direct investment is purchase of share in cash or in kind<sup>38</sup> it excludes those who do not have cash or property. Moreover, the by-laws of the cooperatives may severely limit purchase of shares in kind,<sup>39</sup> thereby limiting membership only to those who afford cash. The principle of open membership would fairly be maintained if members were given the chance to make a contribution to the capital from the surplus return they may get from the purchases they make in the cooperatives,(in the case of consumers' cooperatives) or from the sale price/salary they receive from the goods/labour they supply to the cooperatives(in the case of producers'/workers' cooperatives). If a cooperative is made to start business by the capital of those who have, and were willing to pay the initial capital necessary to start the business, the concept of voluntariness would be reinforced. This would also encourage the social psychology of solidarity and self-reliance.<sup>40</sup> Special cooperative privileges of cooperatives<sup>41</sup> could also be used either to encourage members to contribute initial capital or to obtain a government loan. We should also not forget that cooperatives are formed to solve collective economic problems which cannot be solved on an individual basis. So it is rational for the relatively wealthy, to provide the initial capital and initiate others to join the cooperative and promise to pay the necessary share from future dividend or sale price. This is especially true for consumer and producer cooperatives. Charities could also be an alternative source of working capital. Yet by making contributions to the initial capital of the cooperatives a mandatory requirement for membership, we are equating cooperatives with investor-owned firms. In investor-owned firms, especially in companies, contribution to the capital is a mandatory requirement for membership. Indeed, it is what makes a member a member<sup>42</sup>

### **4.3 Democratic Controls**

Cooperatives are democratic organizations. Each member has an equal right to decide on cooperative affairs. The number of shares a member holds is of no significance to decide on the fate of the cooperatives. Cooperatives are not controlled by the people who have the most money

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<sup>37</sup>Cobia (n 3)247

<sup>38</sup> Ibid

<sup>39</sup> Cooperative Society Proclamation No.147/1998Art 16(4) as amended by Proclamation No.402/2004

<sup>40</sup> Those who contributed the initial capital can sufficiently be rewarded by receiving fixed interest.

<sup>41</sup> Ibid Art 28-31

<sup>42</sup> Commercial Code Art 211 215(2) , 229, 295, 303,312(1), 510(2)



in the organization.<sup>43</sup> Democratic control means one member one vote. The control of the cooperatives is vested in a committee elected by all members on the basis of one man one vote.<sup>44</sup> In investor-owned firms, control of the organization is in the hands of shareholders who control the majority share in the capital. The board of directors or the management of investor-owned firms is appointed and controlled by majority investors in the organization.

Democratic control is intrinsic to cooperatives. Firstly, unlike in investor-owned firms, in cooperatives members are financially interested in their capacity to transact with the cooperative which is at the time of voting.<sup>45</sup> This means what worries each member of a cooperative is not the amount of money he invested in a cooperative, rather the amount he purchases from a cooperative (consumer cooperative) or amount he supply to the cooperative (producers cooperative) or the length of time he work (worker cooperative). The total transaction made by each varies from time to time and cannot at any moment conveniently ascertained.<sup>46</sup> This practical inconvenience therefore leads to a democratic vote.<sup>47</sup>

Secondly, in cooperatives, the members with greater investment in the share capital do not have any better interest on the surplus of the cooperatives since such surplus is distributed on the basis of transaction. Capital in a cooperative is paid a fixed interest.<sup>48</sup> In investor-owned firms, members are interested in share capital since profit is distributed on the basis of share capital.<sup>49</sup>

Thirdly, the principle of democratic control is a manifestation of cooperative intention to remedy the defects of competition and private property ownership.<sup>50</sup> Fourthly, cooperatives are associations of persons who have a collective economic interest. Such interest requires the collective action of members rather than capital. In investor-owned firms, members do not have a collective economic interest. Fifthly, most cooperatives have attempts to reduce the effect of

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<sup>43</sup> J.B. Surridge and Margaret Digby A Manual of Cooperative Law and Practice ( 3<sup>rd</sup> edn Hefer&Sons LTD 1967 ) 5

<sup>44</sup> Ibid p. 6 See also Webbs(n 29)7

<sup>45</sup> Webbs (n 29)6

<sup>46</sup> Ibid 7

<sup>47</sup> Ibid

<sup>48</sup> Ibid 8

<sup>49</sup> Notice that in a company with a limited liability, taking decision on the basis of share is logical since every body loses what he contributes and hence those who contribute has to worry. In fact this logic also equally applies to cooperatives with limited liability.

<sup>50</sup> Ellen Furlough and Carl Strikwerda (eds.) Consumers against Capitalism? Consumer Cooperation in Europe, North America, and Japan 1840-1990(Rowman & Littlefield Publishers INC , 1999).67

economic inequality. So in cooperatives every member has one vote regardless of share capital, time of membership, sex and other factors.<sup>51</sup>

Coming to the Ethiopian Cooperatives Law principle of democratic control, it is not sufficiently safeguarded against the influence of capitalists. Article 5(2) provides that cooperatives are democratic organizations where every member has one vote. However, surplus distributed on the basis of share capital<sup>52</sup> would possibly erode the democratic control in practice, since those who have more shares would have more concern for the surplus of the cooperatives and they would do their best to influence others. Similarly, the limited liability of cooperatives<sup>53</sup> would also create similar tensions since those who invested more would lose more. One may argue that such an effect would be minimal since no member shall hold more than 10% of the total share capital of the cooperative.<sup>54</sup> However, such a limitation applies only on those who want to invest from their pocket where dividends could be used to purchase an unlimited percentage of share capital.

#### **4.4 Principle of dividend on share capital**

One of the areas where Ethiopian Cooperative Law expressly merges cooperatives with investor-owned firms is its clear stipulation of distribution of profit on the basis of capital investment. Members receive dividend from profit according to their shares and contribution to the capital.<sup>55</sup>

Art 33 of the Cooperative Society Proclamation No.147/1998 that had the power to cast doubt on this principle was amended probably to avoid the doubt. This article combined principle of dividend on share capital and dividend on purchase/sale/labour supply. Art 5(3) of the same proclamation reads “(M)embers shall receive dividends from profit according to their shares and contribution...” The combined reading of these two articles may lead one to believe that the word contribution in Art 5(3) was intended to imply principle of mutuality (share of surplus on the basis of purchase/sale/labour supply). However, Art 33 was amended.<sup>56</sup> It is now the power of the general meeting to determine whether to distribute profit on the basis of share capital or

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<sup>51</sup>Webbs (n 29)7

<sup>52</sup>Cooperative Society Proclamation No.147/1998 Art 5(3) cum 33(2) as amended by Proclamation No.402/2004

<sup>53</sup> Ibid Art 10(2)

<sup>54</sup> Ibid 16(5) as amended by Proclamation No.402/2004

<sup>55</sup>Cooperative Society Proclamation No.147/1998 5(3)

<sup>56</sup> Cooperative Society (Amendment) Proclamation No.402/2004 Art 4

mutuality principle or the combination of the two.<sup>57</sup> There is very less possibility for a cooperative to choose the mutuality principle since the guiding principle requires profit to be distributed on the basis of share capital.<sup>58</sup> This eliminates the most accepted definition of cooperatives: "...a user-owned and user controlled business that distributes benefits on the basis of use."<sup>59</sup> This means a cooperative becomes pure profit making entity.

"Pure" or "true"<sup>60</sup> cooperatives have the objective of eliminating profit. This could be done in two alternative ways. The first alternative is trading goods at their production cost. But fixing cost of production was doomed to failure.<sup>61</sup> The cost of production does not necessarily indicate the market price of a good/service and price fluctuates as a result of many causes other than cost of production. Disregarding market price would be counter-productive since it is a key signaling mechanism in market economy which indicates which needs are most urgent.<sup>62</sup> History provides a solution to this problem. The Rochdale Pioneers devised the second alternative, dividend on purchase mechanism.<sup>63</sup> This mechanism enabled members to purchase from, or sell to, or be employed in, a cooperative at a current market price. But, if that price showed a surplus, a member who was the cause for the surplus would take the surplus in the form of refund. This retains consumer freedom of choice, free price mechanism and yet abolishes profit on transactions.<sup>64</sup> Any money that a member gets because of his purchase from a consumer cooperative is not a profit. It is rather a result of saving money by purchasing in a lower price. Dividend is therefore; the money that the consumers/producer/labourers would have lost to a capitalist but has been saved because of their collective action. For the purpose of this research this way of distributing the surplus of a cooperative is called mutuality principle

Abolishing the mutuality principle (dividend on purchase) may even affect the effort of raising capital. Firstly, if people would not get anything in return for the transaction they make with the cooperative they would not be encouraged to become a member. Secondly, cooperatives could attract members if the prospective members feel that they are creating their own shop. Thirdly, in

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<sup>57</sup> Ibid

<sup>58</sup> Ibid Art 5(3) is a guiding principle and has not been amended.

<sup>59</sup> See, Christopher Merrett and Norman Walzer, (eds.) *Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century* ( M.E. Sharpe. Inc. 2004 ) 62 Emphasis added.

<sup>60</sup> Ibid 62

<sup>61</sup> Bonner (n 1)305

<sup>62</sup> Tony Cleaver *Economics :The Basics* (2<sup>nd</sup> ed Routledge 2011) 47

<sup>63</sup> Bonner (n1)305

<sup>64</sup> Ibid

addition to giving economic benefits dividend on purchase would be in conformity of the moral value of those who feel that profit making is stealing the wealth of others.<sup>65</sup> Fourthly, surplus distribution on the basis of share capital would also be a challenge for a government or charities to support cooperatives.

The mutuality principle would even help to accumulate capital<sup>66</sup> better than profit on share capital. A member may be made to accumulate the surplus he receives. Savings and share capital accumulation are made simultaneously. There is no psychological burden on the person to first open saving bank accounts and then go to purchase share in a cooperatives. By one transaction, a person does three things: purchase house hold consumption/sale his product/work as employee, save money and purchase share capital. But if the cooperatives follow the principle of dividend on share capital, only those who already have saving can buy the share capital. Others who could possibly contribute to the capital through the surplus return are excluded. There is less of a possibility for them to save, and then to purchase the share capital either, there might not be proximate bank to save, the person may not have an awareness about saving, he may be tempted to consume all his income at his deposal, his income is insufficient to pay profit to the capitalist and to save to buy share capital of the cooperatives. In Ethiopia, the banking service is unavailable for rural peasants. The income of most Ethiopians is very small.

Dividend on share capital would also discourage collective action of members. Collective action in consumer cooperatives is purchasing from the cooperatives. Selling one's product to the cooperatives is taking collective action in producer cooperatives. Working for the cooperatives (willingness to be employee) is the collective action in Worker cooperatives. Contributing working capital is not the central concern of cooperatives; the central concern is the collective action of members. So it is wiser for cooperatives to give priority to collective action than capital accumulation. Such is possible only if the mutuality principle is strictly adhered to. Member moral responsibility and active participation in other affairs of the cooperatives would also be highly affected. There is no better way to encourage members to glorify the collective action.

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<sup>65</sup> In addition to pure cooperatives and socialists, there are religious authorities who consider profiteering as one form of sin. For the Christian fathers, St Augustine and St Thomas Aquinas equate profit with sin. Muslim scholars do also suspect investor-owned firms of excessive pricing and speculation. See, Steven G. Medema *The History of Economic Thought: A Reader* (Routledge, Taylor & Francis Group 2004) 18 and Roger E. Backhouse *The Penguin History of Economics* (Penguin Books 2002) 34 & 36

<sup>66</sup> Bonner (n 1) 307

Still more, the mutuality principle is the basis of principle of democratic control and open membership.<sup>67</sup> If surplus is to be distributed on share capital the collective interest would be given less attention and private interest takes the center stage. Such would lead to direct or indirect influence on election of representatives who manage the cooperatives. Moreover, restrictions would be imposed on principle of open membership since the already existing members may fear that the additional members would be coming to share from the existing profit.

Finally sharing surplus on the basis of capital would deny the cooperative the logical basis to escape profit tax. Profit tax is imposed on an income which is the result of entrepreneurial activity. Purchasing for one's own consumption or selling one's own primary product at a better price or working as employee is not entrepreneurial activity. Cooperatives remain outside of the realm of entrepreneurs if only if they act as ordinary agents of consumers/producers/workers. This ordinary agency exists when surplus is distributed according to mutuality principle. If surplus is distributed on the basis of share capital it becomes entrepreneurial income (profit).

#### **4.5 Principle of autonomy**

Cooperatives are self-help organizations. They were established by those who realized their own problem and choose cooperation (mutual aid) as a solution and raised the necessary capital themselves without the interference of the government or philanthropists.<sup>68</sup> Accordingly, each member is committed to solving the collective problem and has to take responsibility for the solutions to collective problems. The Owenites were the first to develop awareness of their worsening position as their skills were replaced by deskilled factory processes.<sup>69</sup> They grouped their efforts by experimenting with many different forms of alternative organizations, among them cooperative workshops.<sup>70</sup> These were self-help business enterprises established by the workers with the view to liberate themselves from the capitalists.<sup>71</sup> As noted earlier, the Rochdale Pioneers were the first successful self-help business enterprises. In contrast, Robert Owen's

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<sup>67</sup> Ibid 308

<sup>68</sup> Bonner (n 1)26-27.

<sup>69</sup> Jenny Thornley Workers' Cooperatives: Jobs and Dreams (1<sup>st</sup> edition, Heinemann Educational Publishers, 1981)

<sup>70</sup> Ibid

<sup>71</sup> Ibid

Villages of Cooperation project was criticized since it did not recognize the ability of members to solve their own problems by their own initiatives.<sup>72</sup>

If cooperatives ever need the assistance of philanthropists or the state, care has to be taken that the government or philanthropists do not force their agenda onto the cooperatives. In the process of responding to problems cooperatives have gained invaluable insights. So it may be counter-productive to accept an external solution. Where cooperatives are promoted by the state there is a danger that the power of members to determine rules for their collaboration is limited or even totally eliminated.<sup>73</sup> This happens through the imposition of model bylaws, detailed regulations and direct interference that leaves little room for self-regulation. For that reason, all cooperatives must be vigilant in developing open, clear relationships with governments. Cooperatives are not government agencies. So governments should not use cooperatives as an instrument to implement its policies. Cooperatives are not charities bound to work in accordance with the attitudes of its donors.

However, autonomy does not mean political neutrality. Cooperatives usually disregard political neutrality. In Great Britain most societies are affiliated to the Cooperative Party and this party had a close relation with the Labour Party.<sup>74</sup> There have been socialist cooperatives in Western Europe.<sup>75</sup>

Ethiopian cooperative law expressly recognizes the principle of autonomy. Article 5(4) of the Cooperative Society Proclamation provides as follows:

*“Cooperative societies are autonomous, self-help organizations controlled by their members. If they enter into agreement with other organizations; including governments, or raise capital from external sources, shall do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.”*

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<sup>72</sup> Bonner(n 1) 26-27

<sup>73</sup> Munkner H.H., *Ten Lectures on Cooperative Law* 1982 p.48

<sup>74</sup> Bonner (n 1)308

<sup>75</sup> Ibid 309

## **4.6 Principle of education**

Cooperative education has three major objectives. The first objective is training its members to have a required level of education for the cooperative business. This is technical training such as the art of salesmanship, business management, accounting, and advertising. This makes sure that all those who are associated with cooperatives have the skills they require in order to carry out their responsibilities effectively. The second is ethical training of members. Members should develop an attitude of self-help, self-responsibility, solidarity, democracy, equity, honesty, social responsibility and caring for others. These are fundamental cooperative values that each member has to adhere to. The third is dissemination of the idea of cooperation. The cooperative idea should be made available to the public in general. This would help the cooperatives to get more members. “Effective membership must be based on effective education about the mission and values of cooperation”.<sup>76</sup> It would also help to build the public image of cooperatives.

The Ethiopian Cooperatives Law recognizes technical training and dissemination of the cooperative idea. Article 5(5) states that the cooperatives provide education and training for their members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperatives. Moreover, they inform the general public, particularly young people and opinion leaders, about the nature and benefits of cooperation. However, the law fails to include or at least gives very less attention to the ethical training for members. Educating members is quite a substantial difference to the purely financial transaction of companies.

## **4.7 Principle of cooperation**

Cooperation is the philosophical and ideological foundation of cooperatives. Being emotionally disturbed by the miseries of workers as well as employers, Robert Owen proposed cooperation as an alternative economic system to competition. For Owen human misery was the result of competition and cooperation was the solution. Cooperation is also the manifestation of the cooperative values of voluntariness (caring for others) and solidarity on cooperative level. Cooperatives are mutual associations. There is neither internal (among members) nor external

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<sup>76</sup>, Richard C. Williams The Cooperative Movement: Globalization From Below, (Ashgate Publishing Limited,2007)13

competition. Assisting one another both among members and among cooperatives is the basic ideology that distinguishes cooperatives from investor-owned firms. Investor-owned firms' basic philosophy and ideology is competition both internally and externally.

Moreover, cooperation can practically facilitate the marketing and educational efforts much more effectively.<sup>77</sup> For example, cooperatives can become trading partners. Producer cooperatives and consumer cooperatives may form a trading partnership with the former as a supplier of goods and the latter as market alternatives. Similar relations could also be established between producer cooperatives and worker cooperatives; the former supplies raw materials that the latter may need. By doing so, they could effectively remove intermediaries. That is one way of reducing the cost of production. The principle of education would also be better facilitated through community association of cooperatives than by the individual effort of each cooperative.<sup>78</sup> It is also crucially important for different kinds of cooperative to join together when speaking to government.

There has been cooperation among British retail cooperatives and the Cooperative Whole Sale has been the result of such cooperation. In the United States the National Cooperative Business Association (NCBA) helps to achieve this principle on national level.<sup>79</sup> The International Cooperative Alliance is also responsible for facilitating the principle of cooperation at an international level.<sup>80</sup> In addition to these organizations, there are several websites intended to coordinate cooperative movement.<sup>81</sup>

Ethiopian Cooperatives Law expressly states the need to have cooperation among cooperatives. Cooperatives are expected by the law to work together through local, national, regional and international structures so that the cooperative movement could be strengthened.<sup>82</sup> In order to have effective cooperation, the law allows cooperatives to be established in the form of a primary cooperative, unions, federations and league.<sup>83</sup> Primary cooperatives are established by individuals who live or work in the same area or engage in the same profession.<sup>84</sup> These primary

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<sup>77</sup> Ibid

<sup>78</sup> Ibid

<sup>79</sup> ibid

<sup>80</sup> ibid

<sup>81</sup> Ibid

<sup>82</sup> Cooperative Society Proclamation No.147/1998 Art 5(6)

<sup>83</sup> Ibid Art 6(1) and Council of Ministers' Regulation No.106/2004 Art [3-6]

<sup>84</sup> Council of Ministers' Regulation No.106/2004 Art 3(1)



cooperatives having similar objectives then establish a union.<sup>85</sup> The unions having similar objectives then establish federations, and the federations finally establish leagues at a national level.<sup>86</sup> Unions facilitate cooperation between primary cooperatives, federations facilitate cooperation among unions and league facilitates cooperation among federations in the national level and also represents Ethiopian Cooperatives in the international level.

#### **4.8 Principle of sustainable development**

Ethiopian cooperative law stipulates a principle of sustainable development as one of the principles of cooperatives. It requires the cooperatives to make sure that their economic activities shall be environmentally friendly.<sup>87</sup>

This principle is a new addition to cooperative principles. The other principles are essentially the original Rochdale principles.<sup>88</sup> This principle is developed to protect the environment. In recent times, environmental problems such as atmospheric pollution, marine pollution, global warming and ozone depletion has become a serious challenge to the world community. The correct balance between development and environmental protection is now one of the main challenges facing the international community. Some claim that it is the investor-owned firms who are the major causes of such environmental problems because they are only concerned with short-term returns. In contrast, cooperatives are concerned with long-term development. Cooperatives remedy the defect of competition since they are by the people for the people.

#### **4.9 Conclusion**

In short, the discussion in this Chapter evidences that although cooperative principles are what distinguish cooperatives from other forms of businesses such as investor-owned firms cooperative principles stipulated under Ethiopian Cooperative Law do not distinguish cooperatives from investor owned firms. This is because Cooperative Society Proclamation No.147/1998 has impliedly and expressly modified many of the concepts of the cooperative

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<sup>85</sup> Ibid Art 4

<sup>86</sup> Ibid art 5 &6

<sup>87</sup> Cooperative Society Proclamation No.147/1998 Art 5(7) However; it is not easy to distinguish cooperatives from investor-owned firms on the basis of this principle since both international and domestic laws impose similar duties on investor-owned firms.

<sup>88</sup> Williams(n 75)12

principles that distinguish cooperatives from investor owned firms. The law impliedly limits the principle of voluntariness to defect free consent although this principle extends to the members' commitment to help each other and to high sense of ethical self-disciplining in carrying one's obligation towards the cooperative. More importantly, the law has also effectively ruled out the principle of open membership by (1) failing to state it as an independent principle (the law merges the principle of open membership with principle of voluntariness), (2) empowering the general meeting to limit the capital of a cooperative, (3) making payment of share capital a mandatory membership criteria. The principle of democratic control could also be neutralized by the recognition of distribution of surplus on the basis of capital contribution and the limited liability of cooperatives. More surprisingly, the law has expressly substituted the principle of mutuality by Principle of dividend on share capital. The principle of education, as stated by the law, also fails to give sufficient attention to the ethical training of the members.

We see in the next Chapter whether these defects of the law are remedied or are further exacerbated by the provisions of the law governing ownership and management of cooperatives.

## CHAPTER FIVE

### OWNERSHIP AND MANAGEMENT OF COOPERATIVES UNDER ETHIOPIAN COOPERATIVE LAW

#### **5.0 Introduction**

The ultimate purpose of this chapter is to show that cooperatives in Ethiopia are indistinguishable from investor-owned firms by the ownership and management criteria. The purpose of this is to continue to develop my thesis that the Cooperative Society Proclamation No.147/1998 has failed to keep distinction between cooperatives and investor owned firms. This is done by comparing the relevant provisions of Cooperative Society Proclamation No.147/1998 with their counterparts in the Commercial Code.

Ownership of cooperatives in Ethiopia is closely related to the ownership of investor-owned firms. The Cooperative Society Proclamation No.147/1998 does not impose sufficient limitation, and even impliedly widen ownership rights by giving unlimited power to the founders' meeting and the general meeting. The law fails to expressly state the type of transactional relationship between the owner(s) and the cooperative. It also authorizes the sale of shares to investors. Still more, the law has dispensed cooperatives from principle of open membership and mutuality. The founders' meetings of a cooperative are almost entirely free to determine the owners of the cooperative since the capital of a cooperative and the minimum share capital that each member shall buy are determined the founders. This means they choose who the members are. Moreover, the general meeting of a cooperative may ease some of the restrictions ownership right such a indivisibility of cooperative assets and legal reserve fund by the bylaws. This also means that the general meeting determines what the nature of that ownership is.

The set of powers associated with a general meeting also makes the management of the cooperatives similar with the management of investor-owned firms. Management powers in Ethiopian Cooperatives could be utilized under the law either for profit maximization ends or the personal interest of the management, and in this regard, are therefore often much less likely to be

used for the public interest. This is because the exercise of management powers to determine the objectives of a cooperative are not restricted nor controlled by the law.

In order to demonstrate these points we identify direct and indirect legal restrictions (disincentives) to become member of a cooperative. We also analyze provisions governing transfer of share. The freedom over objectives, the appointment, removal, powers and accountabilities of directors will also be discussed. Although our focus is on Cooperative Proclamation No.147/1998 incidental comparisons would be made with the provisions of the Commercial Code and Public Enterprise Proclamation No.25/1992.<sup>1</sup>

## **5.1 Ownership under Ethiopian cooperative law**

Under this sub topic we deal with two points. The first point identifies direct and indirect legal restrictions (disincentives) to becoming a member of a cooperative under the Cooperative Society Proclamation No.147/1998. It is proved that the proclamation directly and/or indirectly encourages profit-seekers rather than discouraging them. Secondly the owner could transfer his share with very less inconvenience. We begin our discussion by showing characters of profit-seeking ownership and proceed to analyze the legal possibility of these characters to be manifested in cooperatives in Ethiopia.

### **5.1.1 Encouraging Factors**

Here we intend to prove that the proclamation directly and/or indirectly encourages profit-seekers to use cooperative form of economic organization as a competition and profit-maximizing model rather than discouraging them. We begin our discussion by showing characters of profit-seeking ownership and proceed to analyze the legal possibility of these characters to be manifested in cooperatives in Ethiopia.

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<sup>1</sup> Public Enterprises are wholly state owned firms. They carry on economic activities such as manufacturing, distribution, or service rendering activities with the goal of maximizing profits. However; the ultimate objectives of public enterprise may not necessarily be profit maximization; it may be either acting as a catalyst of competition or acting as consumers' agent.

### **A. Characteristics of profit seeking ownership**

In order to identify the nature of ownership in particular cooperatives under Ethiopian Cooperatives Law, it is important to examine the transactional relationship (membership criteria) between owners and the cooperative; which includes having either an open or closed membership, number of shares available to members, investing in investor-owned firms. The criteria for membership directly relates to the nature of ownership. The other factors listed above could indirectly reveal whether the owners of a cooperative are profit seekers (entrepreneurs, capitalist, and professional managers) whose ultimate objective might be profit maximization rather than the promotion of public purposes.

In a firm that ultimately intends to maximize profits, membership is considered closed until new capital is required. Only persons who accept the offer of the owner of the firm can become a member. Even more importantly, the entrepreneur makes his offer discriminately to those persons whom he wants to be his business partners. No one can join his business without his persons whom he wants to be his business partners. No one can join his business with out his (entrepreneur's) consent. Once formed, investor-owned firms do not usually admit new members. Even in cases where the door is opened, entry comes at a higher price for those new entrants than the initial investors paid to form the same investment. Owners do not want to share profits with new investors. Investor owned firms are the result of a contract initiated by an entrepreneur.

However, in the case of a true cooperative, the reverse is true. The ultimate purpose of the true cooperatives is protecting the public interest. As a result, the cooperative is open to all those who are in need and can benefit from its economic activities.<sup>2</sup> So the door is usually open for those who need and can benefit by joining the cooperative at any time, and if they decide to join the cooperative, the price of entry reflects the original contribution of its members. Members benefit from the collective action rather than from the dividend that they can receive at end of each financial year. If membership is ever closed to members, it is closed with the objective of optimizing the result of collective action by those who are current members.

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<sup>2</sup> Compare this with the definition of charitable purposes under Art 14(3) of Charities and Societies Proclamation No.621/2009

Usually investor-owned firms do not impose limitations on the percentage of shares in the capital one investor can gain: in the capitalist culture governing investor-owned firms investors are usually invited to invest as much as they can. For example, under the Ethiopian Commercial Code, the capital of a share company established by public subscription would be approved by a meeting of the subscribers.<sup>3</sup> Even after formation, a firm may further increase its capital if investors are willing to invest their capital in the firm.<sup>4</sup>

However, in ‘true’ cooperatives which are not concerned with profit maximization objectives, the equality of its members is maintained by limiting shareholding in the capital i.e. each member may only hold a limited amount. Such limitation also protects the cooperatives from being intruded by capitalists.

The other factor that may implicate whether a cooperative is owned by profit seekers or real user<sup>5</sup> is the possibility of reinvestment of profits from the cooperative in an investor-owned firm. The ultimate purpose of profit seekers is to search for all options that can maximize the end return of their investment. This means if the owners of profit seeking firms are convinced that reinvesting the annual profit income of the firm would increase their future dividend they would authorize the firm to buy shares in another profit seeking firm. But the ultimate purpose of true cooperatives is to increase the quantity and quality of service they receive from the firm. So they invest any surplus of their firm in the expansion of infrastructure of the firm so that the quantity and quality of service they receive from the firm increases. Any money that may be left from infrastructure expansion would be used for future reserve and social service. True cooperatives also have charitable tendencies.

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<sup>3</sup> Commercial Code Arts 318-322

<sup>4</sup> In exceptional cases, however, since investor-owned firms are the result of freedom of contract, the agreement that creates them (memorandum and articles of association) may limit the shareholding of members. Sometimes the state may also limit shareholding of members by law so that the state is able to regulate the activities of the firm. For example, in order to regulate the financial sector of the economy, the Ethiopian Government issued banking and insurance regulations which prohibits an individual from holding more than ten percent of the share capital of a bank or insurance firm. Banking Proclamation No.83/1992 and Insurance Proclamation No.84/1992

<sup>5</sup> Here the word ‘users’ is used to indicate producers of primary product in producer cooperatives, consumers and labour suppliers to workers cooperatives.

Another indirect indicator of whether the cooperative is owned by the profit seekers or real users is the nature of its clientele. Profit seekers may be organized in a cooperative form as far as they believe that such a form would make them more profitable.<sup>6</sup> Thus, owners of a profit seeking cooperative may be suppliers of raw materials/labour to the cooperative or purchasers of the goods/services of the cooperative. However, the cooperative could still continue to buy raw material/labour from non-members or sell its goods/services to non-members. It is not usually ready to admit these clients as its members since it makes profit from these clients. Membership is closed. But in true cooperatives the service is available to members only. Any person who wants the service has to become a member. Profiteering from the transaction of non-members is unacceptable.

Let us now turn to the analysis of the Ethiopian cooperative law and determine whether the law opens the door to profit seekers or whether it assists in deterring them.

## **B. Transactional relationships between owners and the cooperative (membership criteria)**

Here we examine the transactional relationships<sup>7</sup> that the Ethiopian Cooperatives Law allows to exist between the owners of the cooperatives and the cooperatives itself.<sup>8</sup>

### **Lender-Borrower Relationship possible**

Without doubt, Ethiopian cooperatives law allows, and may even encourage, owners to have supplier/purchaser transactional relationship with the cooperatives (user ownership). This can be easily inferred from Art 2(1) which enumerates types of cooperatives. The inclusion of the concept of collectivity in the definition of cooperatives could also be taken as an additional indicator.<sup>9</sup> The missions and goals of cooperatives, as indicated under Art 4, may also show user ownership. A cooperative could be owned partly by producers (suppliers of raw materials or marketable goods), partly by consumers and partly by workers. This is because the cooperatives may engage in production, services or both.<sup>10</sup>

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<sup>6</sup> See our discussion in Chapter Two

<sup>7</sup> The concept of transactional relationship has been discussed under Chapter Two supra pp.35-38, 40-45

<sup>8</sup> See detail discussions of membership criteria in Chapter Three.

<sup>9</sup> See Cooperative Society Proclamation No.147/1998 Art 2(2)

<sup>10</sup> Ibid Art 7

However, the law's failure to expressly state the type of transactional relationship between the owner(s) and the cooperative opens the door to profit-seekers who wish to hide under the guise of a cooperative. It does not expressly rule out the possibility of lenders and borrower transactional relationship between the owners and the cooperative. This leaves an opening for the lenders of the cooperative to become its owners, though this opening may not be wide enough to allow entry comfortably due to the general understanding about concepts of cooperatives. However, the principle of dividend on share capital makes the opening wide enough for lenders of capital to become owners.<sup>11</sup> The fact that it is necessary for a member to pay share capital when it is decided in a general meeting further widens the opening.<sup>12</sup> However; in user ownership capital contributions are not a mandatory condition to joining a cooperative, a member may gradually accumulate his share of capital by having continuous transactions with the cooperative.<sup>13</sup>

The legal authorization of selling shares to non-members may even be taken as a clear permission of the intrusion for profit seekers to enter into the ownership of cooperatives. According to Art 16(6) of Cooperative Society Proclamation No.147/1998, whenever a cooperative faces a shortage of capital it “may sell certain shares to a person who is not a member of the (cooperative) without contradicting the principles of the (cooperative).<sup>14</sup> If we take this article to mean that the general meeting sells shares only when it wants to sell i.e. membership is closed then we contradict the principle of open membership. So the safest way of construing this article is to allow profit seekers to have ownership rights in a cooperative whenever users are unable to raise the necessary capital. This construction is also supported by the principle of dividend on share capital.<sup>15</sup> The by-laws may lay down procedures and criteria that invite profit seekers.<sup>16</sup> In short, the law opens the door for lender cooperatives.

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<sup>11</sup> For details see Chapter Four.

<sup>12</sup> Cooperative Society Proclamation No.147/1998 Art 13(2) and Art 16(1&2) as amended. Notice that, before Art16 was amended, capital was to be collected to expand the activities of the cooperatives but after amendment the capital is to start its function.

<sup>13</sup> See for details of alternatives of obtaining capital to start in Chapter Four.

<sup>14</sup> Emphasis added and the brackets are substitution of the word ‘society’ with the ‘cooperative.’

<sup>15</sup> Before it was amended by Proclamation 402/2004 Art 16 did not authorize the general meeting to sell share to non-members. It was also by amendment of sub-article 1 of Art 33 that deduction from net profit is limited only to legal reserve fund. Before the amendment the deductions were to be made not only for legal reserve but also for expansion works and for social services. It was also by amendment of sub-article 2 of the same article that the distribution of dividend on the basis of shares the members have in the society and on amount of goods effected for the sale to the cooperatives or goods purchased from the cooperatives by the member of the cooperatives was



### **Closed membership possible**

In profit seeking enterprises, membership is closed. In partnerships, and sometimes in private limited companies, personal identity is indispensable. Thus, an offer for membership is open only for persons identified in advance. Once a partnership or a private limited company is formed, no one is allowed to join. As an extension of this closed membership members are not entitled to transfer their shares to non-members without the consent of other members.<sup>17</sup> Although personal identity may not be very important in public companies, it may be formed between individuals who know each other without giving any opportunity for those who have intentions to become a member.<sup>18</sup> It is up to the entrepreneur whether or not to offer the share to public.<sup>19</sup> Once the company is formed, membership is closed and it could be reopened in the future by the decision of the extraordinary meeting of shareholders to increase the capital of the company by selling new shares. Although transfer of shares may allow new shareholders to join the company, the memorandum or articles of association may impose certain limitation on such transfers.<sup>20</sup>

When we come to Ethiopian cooperatives law, it provides almost the same thing with the commercial code. Firstly, it gives less attention to the principle of open membership.<sup>21</sup> Secondly, it empowers the founders' general meeting to determine the total number of shares to be sold.<sup>22</sup> Thirdly, it also assumes that there is fixed capital.<sup>23</sup> If the general meeting wants more capital, it would open a door for new membership.<sup>24</sup> Such authority derives the founders to offer membership to persons identified in advance. User cooperatives could not normally fix capital levels, since frequent changes due to principle of open membership makes the capital indefinite. Furthermore, members of user cooperatives may not necessarily contribute capital. Fourthly, it

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repealed and the general meeting was given full power to determine the criteria to distribute profit. See Proclamation 402/2004 These changes altogether may imply that the amendment was made in order to enable cooperatives to resolve their financial problems by appealing to capitalists/profit seekers.

<sup>16</sup>Cooperative Society Proclamation No.147/1998 Art 16(7) as amended by Proclamation No.402/2004

<sup>17</sup> See Commercial Code Art 250, 282, 302, 522 and 523

<sup>18</sup> Ibid Art 316

<sup>19</sup> Ibid Art 317 and 318

<sup>20</sup> Ibid Art 333

<sup>21</sup> See our discussion in Chapter Four

<sup>22</sup> Ibid Art 16(1) cum. (2) cum (3) cum(5)

<sup>23</sup> Ibid Art 16(2) cum (3)

<sup>24</sup> Ibid Art 16(3)

mandatory requires every member to contribute initial capital. Capital contribution may also serve as a means to block the poor from joining the cooperative.

### **No Share Limitations**

As it can be expected, the Ethiopian Commercial Code does not provide for a maximum ceiling on the percentage of individual shareholding. Only in the banking and insurance sectors of the economy does Ethiopian Law provides limits for individual shareholding at a maximum ceiling of ten percent of the capital, though, the memorandum or articles of association may provide for a maximum individual holding.

Almost the same is true in a cooperative. In principle, Ethiopian cooperative law limits the individual shareholding at maximum of ten percent of the capital.<sup>25</sup> However, if a member is reinvesting the dividend he received from the cooperative; such a limitation may be waived.<sup>26</sup> Moreover, since there is no legal mechanism to control nominal members, there is a possibility that some of the members may actually hold more than ten percent of that capital. Thus, legal limitations may be an apparent limitation only.

### **Investing in profit seeking firms**

It is not expected from the Ethiopian Commercial Code to impose any limitation as to where a firm reinvests its profit. A firm can reinvest its profit in any business activity and/or any kind of firm provided the highest management organ authorizes such investment.<sup>27</sup>

Although the Ethiopian Cooperatives Law is expected to impose limitation on the reinvestment of the profit of the cooperatives, there is no express or even implied limitation in the law. So the

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<sup>25</sup> Cooperative Society Proclamation No.147/1998 Art 16(5) In 'true' cooperatives members usually have equal share in the capital and it is difficult to fix percentage of shareholding in a capital in advance since the capital is expected to moves up ward due the principle of open membership.

<sup>26</sup> Ibid Art 33(3) Although it is possible to argue that a member could reinvest his dividend until his total shareholding reaches ten percent of the capital such argument is implausible since it makes this article ineffective when seen in light of Art 16(5).

<sup>27</sup> Since agency power is interpreted narrowly (see Civil Code Art 2181(3) and managers who enter into contract (purchasing shares from firms) are agents (see Commercial Code Art 216) and most of the time the memorandum and articles of association do not expressly authorize directors/managers to reinvest the profit, the owners of the firm have to expressly authorize the reinvestment of the profit.

general meeting of a cooperative may authorize the executive organ to buy shares in profit seeking firms. It is suggested that this in turn makes the cooperative a profit seeking firm.

### **Service to non-members**

It would have been surprising if the Commercial Code had expected the firm to trade with its owners. Profit seeking firms intend to make profit by supplying goods/services to others at a price that exceeds cost of production of the goods/services. In contrast consumer cooperatives are intending to provide goods/services to members at the cost of production.<sup>28</sup> Similarly producer/worker cooperatives are intending to sell the product/labour of members at its real market price. This means that Ethiopian cooperatives are expected to limit the consumer cooperatives to the supply of its goods/services to members only; and producer/worker cooperatives to purchase merchandisable goods/service or labour from members only. However, the law neither expressly nor impliedly contains such a limitation. Even more; the law seems to impliedly authorize a supply to non-members or purchases from non-members. This is because the law declares distribution of profit on the basis of shareholding as a guiding principle of cooperatives. Thus consumer cooperatives in Ethiopia may make profit by selling goods/services to non-members at a price that exceeds the cost of production.<sup>29</sup> Similarly producer/worker cooperatives in Ethiopia could make a profit by buying goods/labour from non-members and reselling it at a price that exceeds its cost of production. Thus, Ethiopian cooperative law never recognizes the basic idea of users-owners and users-benefits that clearly distinguish true cooperatives from profit seeking firms.

### **5.1.2 Legal limitations on ownership rights in a cooperative**

Under the subtopic ‘theory of the firm,’ we saw that the cost of contract and the cost of ownership affect the assignment of ownership in a free market economy. By the term ‘free market’ it is intended to mean a situation where almost every price of goods/services is

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<sup>28</sup> Any price collected in excess of cost of production is returned to the purchaser at the end of the financial year.

<sup>29</sup> Profit could also be derived from members since members could not get share of dividend in accordance of the transaction they made.

determined by supply and demand. In such economic systems, freedoms of contract and ownership rights are very wide.

However, in practice, the state influences the supply and demand side of the economy by its policies and laws. State interference in the economy is designed to protect certain interests. Such interests may be either the interest of the majority in a democratic system or the interest of a powerful few in the case of non-democratic states. Depending on the type of interest, the state intends to protect itself using law as an instrument. The law may encourage one form of ownership assignment and discourage another by either widening or limiting freedom of contract and ownership rights. The law would therefore create additional costs on assignment of ownership.

Here we intend to show that the Ethiopian Cooperatives Law creates insignificant costs on the assignment of ownership. This may have implications in respect of enabling profit seeking. To this effect, the extent of the indivisible property of a cooperative and considering the amount of legal reserve and its use, the profit sharing principle, shareholders' rights (such as voting, transfer of shares, non-expulsion, access to grievance hearing organ) and restriction on borrowing and on loans are discussed.

### **Collective ownership Not Necessary**

The value of goods depends on the extent of legal entitlement to utilize such goods to the satisfaction of human desire.<sup>30</sup> The legal entitlements on a good are called property rights. Depending on the details of a legal entitlement, property rights can be classified into possessory rights and ownership rights. A person who has possessory rights on a good is entitled to administer and use the good.<sup>31</sup> A person who has ownership rights can administer, use the good and its fruits and dispose the good and its fruits. Ownership is the widest right that may be had

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<sup>30</sup> Martin Ricketts (ed), *The Economics of Modern Business Enterprise: The International Library of Critical writings on Economics Series* (Edward Elgar Publishing, 2008) 87

<sup>31</sup> See Civil Code Art 1140-1150

on a good.<sup>32</sup>In principle it indivisibly combines *usus* (possessory rights), *usus fructus* (own the natural fruits a good) and *abusus* (destroy, transfer or transform the good).<sup>33</sup>

However, the law imposes restrictions on ownership rights.<sup>34</sup>Depending on the ultimate policy objectives of a Government, such restrictions may create different types of ownership rights. Private ownership rights, communal ownership rights and collective ownership rights are the prominent types of ownership rights.<sup>35</sup> Private ownership rights means the owner of the good and no one else has the authority to decide how the good should be used. Private ownership rights are the widest type of ownership right. It combines *usus*, *usus fructus* and *abusus*. One person or several persons jointly may have private ownership rights on a good.<sup>36</sup>

Communal ownership rights are when many persons have the right to use a thing for the same purpose. Communal ownership right is usually associated with land or forest ownership rights. It includes rights to way, cutting wood, grazing animals, and irrigation on the communal land. “Other important examples of communal rights might include the right to use a watercourse for the disposal of waste products or the right to fish on a particular stretch of water or at sea or the right to allow smoke or other waste gases to escape into the air.”<sup>37</sup>Communal ownership rights give lesser rights to owners when compared to private ownership. The ownership rights can never be given to an individual, it is given to a community. The individual has no rights of administration and disposal, and his right is limited to the use of the goods without unnecessarily affecting similar rights of other members and he cannot transfer such use rights. It is the community that has the power to administer the goods including allowing new comers to use them.<sup>38</sup>However, even the community cannot transfer the ownership of the goods to others and the community cannot order the partition of the goods among members.<sup>39</sup>

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<sup>32</sup> Ibid Art 1204(1)

<sup>33</sup> Ibid Art 1204(2), 1205, 1206

<sup>34</sup> Ibid

<sup>35</sup> Ricketts (n 30) 88-92. Also see Civil Code Title VII-IX

<sup>36</sup> See Civil Code Art 1257

<sup>37</sup> Ricketts (n 30) 89

<sup>38</sup> Goods are either movable or immovable. Immovable is either land or building. See Civil Code Art 1126 & 1130

<sup>39</sup> The Federal Democratic Republic of Ethiopia Rural Land Administration and Land Use Proclamation No.456/2005 define communal land holding as follows: “Communal land holding means rural land which is given by the government to local residents for common grazing, forestry, and other social services.” Notice that Art 40(3) of the FDRE constitution reserves ownership right on land exclusively to the state.

Collective ownership is a form of ownership that gives the least legal entitlement to the owners. Unlike private ownership but like communal ownership, collective ownership always presupposes plurality of owners. Moreover, transfer of ownership or division of the property among the members is not possible. An individual member with a collective ownership right can never decide how or when to exercise his use right. With collective ownership rights, the right is a shared right.<sup>40</sup> The decision about the use of the resource is taken as a group.<sup>41</sup> Private ownership is the characteristics of capitalist/market economy. Communal ownership is the characteristics of subsistence agriculture or pastoral life. Collective ownership is often the manifestation of command or cooperative economy.

Collective ownership rights have the characteristics of ownership rights in true cooperatives. A cooperative intends to become the building block of society. This means they are established for an undetermined period of time. There is no presumption of future division of the property between cooperative members. The members, and would be members, are presumed to have equal claim on the property of the cooperative. That is why true cooperatives adhere to the principle of open membership without making any change to the par value of shares.

Although, it provides for the indivisibility of assets and funds of the cooperatives, Ethiopian cooperative law cannot guarantee the continuous existence of collective property rights in a cooperative. A fund of a cooperative can be divided up to its members only if the fund is the annual net profit of the cooperative.<sup>42</sup> Assets of a cooperative could be divided to members only if the cooperative is liquidated after dissolution.<sup>43</sup> Moreover, a fund which is not an annual net profit and/or any assets of the cooperative can not also be transferred to third party. This indivisibility is an indication of collective ownership rights. However, this collective ownership right may be eroded if a cooperative is owned by profit seekers. There are legal provisions that can be utilized to this purpose. To start with, the founders' meeting is empowered to fix the capital of a cooperative. The founders' meeting may keep this capital to the bare minimum so that the cooperative could have almost no worth. Worth is not a necessary condition to make

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<sup>40</sup> Ricketts (n 30) 89

<sup>41</sup> Ibid

<sup>42</sup> Cooperative Society Proclamation No.147/1998 Art 32

<sup>43</sup> Ibid

large profits.<sup>44</sup> The source of the fund of a society is its annual profit,<sup>45</sup> but only 30% of this annual profit goes to the collective ownership.<sup>46</sup> The remaining 70% is distributed to members as a dividend.<sup>47</sup> This 30% continues to be accumulated until it reaches 30% of the capital.<sup>48</sup> Since the capital may be very minimal, the cooperatives may reach this 30% in one financial year or a shorted period of time. The general meeting may also decide to dissolve a cooperative if the members are willing to divide the property of the cooperative.<sup>49</sup>

### **Legal reserve as Creditors' Guarantee**

Under the Commercial Code, a reserve fund is intended to increase the security of creditors of a firm. Only firms with limited liability (companies) are required to maintain a legal reserve fund.<sup>50</sup> There is no legal reserve fund requirement for a partnership since there is no fixed capital and liability is unlimited.<sup>51</sup> In company limited by shares, the legal reserve fund is at least five percent of the annual net profit until it reaches 20% of the capital.<sup>52</sup> In a private limited company, this five percent continues until it reaches ten percent of the capital.<sup>53</sup> Banking and insurance companies are expected to keep an additional reserve fund in the National Bank of Ethiopia.

Similarly under Ethiopian cooperative law, the legal reserve is intended for the security of the cooperative's creditors. A cooperative's liability is limited. Before it was amended in 2004, Ethiopian cooperative law expected a cooperative to carry out expansion work and social services.<sup>54</sup> Now there is no such expectation. Then the purpose of a legal reserve fund is only for the security of creditors.

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<sup>44</sup>See Chapter Two.

<sup>45</sup>The fact that the law does not define profit of a cooperative any income obtained from whatever source including government assistance and charitable donations may be taken as profit of a coop. Moreover; there is a possibility that the cooperative may consider income from depreciation of business asset as annual profit.

<sup>46</sup>Cooperative Society Proclamation No.147/1998 Art 33(1) as amended

<sup>47</sup> Ibid

<sup>48</sup> Ibid

<sup>49</sup><sup>49</sup> Ibid Art 40(1)

<sup>50</sup> Commercial Code Art 454, 539

<sup>51</sup> Ibid Art 255, 289, 296

<sup>52</sup> Ibid Art 454

<sup>53</sup> Ibid Art 539

<sup>54</sup> Cooperative Society Proclamation No.147/1998 Art 33(b) and 33(c)

### **Egoistic Profit sharing principle**

Ethiopian cooperative law imposes the model of economic egoism on a cooperative. Profit seekers prefer a firm that enables them to maximize the net return from their investment. They do not want to forgo any benefit for the benefit of others. Ethiopian cooperatives law squarely fits this egoistic rationality. First, the law expressly stipulates profit sharing in accordance with investment as a guiding principle of cooperatives.<sup>55</sup> When we continue our analysis, we find a provision that totally leaves the criteria of distributing profit to the general meeting.<sup>56</sup> This means taking egoistic rationality as its principle the general meeting may decide on distribution in accordance with capital investment in a cooperative. True cooperatives do not adhere to the principle of egoistic rationality. They have purposes to attain other than enabling members to accumulate wealth. The principle of profit sharing under Ethiopian cooperative law is even more difficult for true cooperatives since it follows egoistic principles of market economy.

### **Wider Shareholder rights**

It is self-evident that shareholders prefer a type of firm in which they can have a wider property right on their shareholding. Let us now compare the rights of members in a cooperative under Ethiopian cooperatives law and shareholders' rights under the Commercial Code. Members'/shareholders' rights include a power to transfer of shares, voting rights, a defence against non-expulsion and access to a grievance procedure.

#### *Transfer of shares*

By transfer of shares it is intended to mean the ending of one's ownership right in a firm either by transferring the ownership right to a third party or by withdrawing after receiving proportional payment. It is obvious that the right to transfer ownership right to a third party is broader than the right to withdraw upon receiving proportional payment. This is because the right to transfer to a third party gives the owner the opportunity to choose wider options of transferring rights. However, although it benefits the withdrawing partner it may adversely affect the remaining partners, left with a new partner.

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<sup>55</sup> See further discussion in Chapter Four

<sup>56</sup> Cooperative Society Proclamation No.147/1998 Art 33(2) as amended by Proclamation No.402/2004



Under the Commercial Code there are four types of partnership and two types of company. The four types of partnerships are ordinary partnerships, joint ventures, general partnerships and limited partnerships. Ordinary partnerships carry out non-commercial economic activities such as agriculture, forestry, fishing and cottage industry.<sup>57</sup> Other partnerships could choose to carry out either commercial or non-commercial economic activities.<sup>58</sup>

In an ordinary partnership, it is not possible to assign all the rights; the owner member can only assign the usufructuary rights.<sup>59</sup> A partner can however, withdraw from the partnership by selling his share to the partnership “in cash, on the basis of the value of his right on the day when he leaves the partnership.”<sup>60</sup> In a general partnership, assignment of ownership is allowed if all members agree, although the memorandum of association may provide for the sufficiency of a majority.<sup>61</sup> A member of a limited partnership has an alternative to leave the partnership either by selling his share to the partnership or to a third party.<sup>62</sup> But transfer to a third party is conditional upon the consent of managers and majority members.<sup>63</sup> Unless otherwise agreed to continue the partnership, all types of partnership would be dissolved upon incapacity, death, bankruptcy or attachment of a share of any partner.<sup>64</sup>

Companies are of two types; share companies and private limited companies.<sup>65</sup> They are always commercial regardless of the nature of their economic activity.<sup>66</sup> In a share company, a shareholder could freely transfer his shares to third parties, although the company can include the right to preemption in the memorandum of association.<sup>67</sup> However, in a private limited company, free transfer of share is possible only between members.<sup>68</sup> Any transfer of shares to non-member

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<sup>57</sup> See Commercial Code Art 5-9, 10(1), 213(1)

<sup>58</sup> Ibid Art 213 10(1)

<sup>59</sup> Ibid Art 250

<sup>60</sup> Ibid Art 262(1) emphasis added

<sup>61</sup> Ibid Art 282 The law is silent whether or not the partner has the right to withdraw by selling his share to the partnership.

<sup>62</sup> Ibid Art 303 & 302

<sup>63</sup> Ibid Art 302 The law is silent on joint venture.

<sup>64</sup> Ibid Art 260, 295 & 303

<sup>65</sup> Ibid Art 10(2), 212(1)(e), 212(1)(f)

<sup>66</sup> Ibid Art 10(2)

<sup>67</sup> Ibid Art 333

<sup>68</sup> Ibid Art 523(1)

requires the approval of at least the majority of members holding 75% of the share capital.<sup>69</sup> Both in a share company and a private limited company, the law never entitles the shareholder to force the company to buy his share.<sup>70</sup> In a case of the death of a shareholder, their shares are transferred to their heir in accordance of the inheritance law.<sup>71</sup>

In general, the right to transfer their share in cooperatives is wider than it would be under a partnership and a private limited company, but a little narrower than under a share company (to a public company). A member who wants to end his ownership rights in a cooperative has two alternatives. The first alternative is to demand the cooperative to pay him his proportionate share in the property of the cooperative.<sup>72</sup> The second alternative is to transfer his share to a third party (member or non-member) on condition that the management committee approves the transfer.<sup>73</sup> Upon the death of a member their share is paid to their heirs in accordance with inheritance law, but non-member heirs have to get the permission of the management committee if they want to become a member.<sup>74</sup>

#### *Voting rights*

Voting rights of an owner in a cooperative are less favorable when compared to a partnership and a company under the Commercial Code. The first disadvantage to an owner in a cooperative is that the shareholder has only one vote regardless of the amount of his shareholding, and it may not be possible to change this by using by-laws.<sup>75</sup> But under the Commercial Code, both in partnerships and companies, voting in principle depends on the number of shares the person has in the firm.<sup>76</sup> The second is that when a cooperative makes a decision, it is always passed by a majority vote whatever its nature may be.<sup>77</sup> However, in a partnership, any amendment to the

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<sup>69</sup> Ibid Art 523(2)

<sup>70</sup> However; shareholders in a share company which changes nature or object of the company or transfers head office abroad may withdraw from the company and have their shares redeemed. See Ibid Art 463

<sup>71</sup> Ibid Art 524

<sup>72</sup> Cooperative Society Proclamation No. 147/1998 Art 14(1(d)

<sup>73</sup> Ibid Art 19(1)

<sup>74</sup> Ibid Art 19(2) & 19(3)

<sup>75</sup> Ibid Art 18(1) & 5(2) Although one may argue that cooperatives could provide for vote according to use or capital contribution it would not be as such easy to convince the organ that registers cooperatives due to the nature of true cooperatives and also the law expressly provides democratic control in the definition of cooperatives as well as in the guiding principle of cooperatives. See Art 2(2) and 5(2)

<sup>76</sup> See Commercial Code Art 234, 295,, 303, 407, 534(2)

<sup>77</sup> Although Art 11(3) the Ethiopian Cooperatives Law provides that the by-laws can be amended by special resolution, it does not give any veto power to individual shareholder. Special resolution means resolution passed by a two third majority of the members. See Ibid Art 2(5)

memorandum of association or appointment of an attorney requires the unanimous consent of all members.<sup>78</sup> In companies, the nationality of the company can be changed only if there is unanimous vote to that effect.<sup>79</sup> More importantly no member may be required to increase his contribution without his consent.<sup>80</sup> However, although the law is disadvantageous for the minority, it could make space for the majority to pursue a profit-seeking motive even if it is at the cost of minority members. This dictatorship of the majority without any minority rights may encourage profit-seekers to further subvert the public objectives of a cooperative in favour of profit seeking objectives.

#### *The right of non-expulsion*

Another area where Ethiopian cooperative law opens the door to profit seekers is the right of non-expulsion. In general partnerships, limited partnerships and companies there is an absolute immunity from expulsion either by the decision of shareholders or a court. A shareholder can withdraw from a firm only upon his own decision. Under ordinary partnerships a member may be expelled from the partnership by a court order.<sup>81</sup> However, under a cooperative a member may be expelled from membership by a decision of a general meeting.<sup>82</sup> Again although the law is disadvantageous for the minority, it could make space for the majority to pursue a profit-seeking motive even if it is at the cost of minority members. This dictatorship of the majority without any minority rights may encourage profit-seekers to further subvert the public objectives of a cooperative in favour of profit seeking objectives. They would threaten to dismiss any member who may stand against their profit maximizing motives.

#### *Access to grievance hearing organs*

The Commercial Code leaves to the freedom of the members of a firm to decide on an appropriate dispute settlement mechanism. Thus, whenever he/she feels aggrieved, a member may choose either public or private dispute resolution mechanisms. Even among the private dispute resolution mechanisms (negotiation, conciliation, mediation and arbitration) members may choose the one suitable for their case. However, this freedom is limited in a cooperative.

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<sup>78</sup> See Commercial Code Art 233(1), 235, 295 and 303

<sup>79</sup> Ibid Art 425(2) and 536(1)

<sup>80</sup> Ibid Art 425(2) and 536(2)

<sup>81</sup> Ibid Art 261

<sup>82</sup> Cooperative Society Proclamation No.147/1998 Art 15(2)

Under Ethiopian cooperatives law, a member who has a grievance is not entitled to choose public dispute mechanism.<sup>83</sup> He can go to court only by appeal.<sup>84</sup> Even in private dispute resolutions, it seems that he is limited to conciliation and then arbitration.<sup>85</sup> This is the only point where the cooperative law appears to be unfavorable to profit-seekers.

#### *Restriction on borrowing*

Ethiopian cooperative law requires the by-laws of a cooperative to provide the amount (at least the maximum) and conditions of borrowing money both from members and third parties.<sup>86</sup> This restriction (although nominal since the general meeting could modify the by-laws by two-third majority) seems to have intended to protect the creditors of the cooperative since the cooperative is of a limited liability (and even the cooperative itself from rent-seeking members). This is because there is no such similar restriction under a partnership, which has unlimited liability, and private limited company whose general manager is answerable to the creditors for any breaches of their duties.<sup>87</sup> In a share company, there is no restriction on borrowing from a shareholder but borrowing by a member of board director has to be supervised.<sup>88</sup>

#### *Restriction on lending*

Art 35 of the Cooperative Society Proclamation No.147/1998 prohibits cooperatives from lending money to non-member individuals or non-cooperative associations. This article is somewhat ambiguous. If it is referring to saving & credit cooperatives, it can be interpreted as simply stating the concept of user ownership. However, this alternative is unconvincing since the law cannot restrict user ownership to only saving and credit cooperatives without saying anything about other types of cooperatives. It should be referring to any type of cooperative in order to curb them from over-utilization of banking transactions under the guise of attaining their cooperatives objectives. Under Ethiopian law, it is a criminal act to give a loan without getting a license from a national bank. However, cooperatives are entitled to extend loans to members

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<sup>83</sup> Ibid Art 46-49

<sup>84</sup> Ibid Art 52

<sup>85</sup> Ibid Art 46 & 47(1)

<sup>86</sup> Ibid Art 34 as amended by proclamation No.402/2004

<sup>87</sup> Commercial Code Art 530

<sup>88</sup> Ibid 356

without such licenses. This could even be taken as a positive advantage of cooperatives over investor-owned firms.

## **5.2 The Management of Cooperatives under Ethiopian Cooperative Law**

In chapter two, we saw that when ownership is separated from the management, the management bodies may use their position to satisfy their personal interests or to satisfy the interest of the public. The corollary to this is that when management is in the hands of owners they may use their power for profit maximization a more common outcome as “there is a growing amount of scholarship which indicates that there has been no separation of control from ownership.”<sup>89</sup>

The legal power and accountability of a management organ greatly influences the ultimate motive of an economic organization. Accordingly, it influences profit-seekers’ choice of types of economic organization. Profit-seekers normally prefer a form of economic organization that greatly minimizes separation of management from ownership. In this subtopic our ultimate purpose is to determine whether the provisions of Cooperative Society Proclamation No.147/1998 minimize separation of control from ownership. Put in a question form; can the owners use the management of cooperative to advance their profit-maximizing motive?

### **A. The management organs of Ethiopian cooperatives**

The management structure of Ethiopian cooperatives is similar to profit making businesses.<sup>90</sup>Under Ethiopian cooperatives law, there are three management organs of a cooperative; general meetings, the management committee and the control committee.<sup>91</sup>General assembly is a meeting of members of a cooperative.<sup>92</sup>The management committee means a body elected by the general assembly with the responsibility to manage the activities of the society.<sup>93</sup>The members of the management committee are normally members of the cooperative.

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<sup>89</sup> Lorraine Talbot, *Critical Company Law*(Routledge-Cavendish, 2008) 139

<sup>90</sup> The management structure of charities & Societies in Ethiopia is of two level; the general meeting of members and a board of directors. The board of directors has both the policy making and agency power. There is no concept of general manager and auditor. See Civil Code Art 426-450

<sup>91</sup> Cooperative Society Proclamation No.147/1998 Art 20, 23, &25

<sup>92</sup> Ibid Art 2(4)

<sup>93</sup> Ibid Art 2(6)

The control committee is a committee established by the general assembly to audit the activities of the management committee.<sup>94</sup> These organs may have subcommittees.<sup>95</sup>

Contrary to investor-owned firms, under the Commercial Code and the Public Enterprise Proclamation, Ethiopian cooperative law does not expressly recognize the office of the general manager. In addition to shareholder meetings, (equivalent to general meeting), board meetings (equivalent to management committee), and auditors (equivalent to control committee), share companies have the office of a general manager.<sup>96</sup> Although other forms of investor-owned firms (partnerships & private limited company) are not required to have board and auditors, (if they like, owners may establish an office of the board of directors and auditors), they have general meetings and a manager.<sup>97</sup> The management structure of a public enterprise is equivalent to share company; it has supervising authority (which is equivalent to share holders' meeting), a board, a general manager and auditors.<sup>98</sup>

Now one may ask whether or not the owners of a cooperative can establish an office for a general manager.<sup>99</sup> The reading of Art 24 of the Cooperative Society Proclamation No. 147/1998 implies that owners of a cooperative are entitled to appoint a manager since the provision limits the power of the management committee to policy making.<sup>100</sup> This is because there is very little written in this article on the power of agency.<sup>101</sup> A manager is an agent that enters into a contract on behalf and by the name of a firm.<sup>102</sup> More strongly, since the by-laws expressly allow the

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<sup>94</sup> Ibid Art 26

<sup>95</sup> Ibid Art 27

<sup>96</sup> Commercial Code Art 347, 348, 368, 388

<sup>97</sup> See Ibid Art 233-236, 275, 287, 295 and 303. Notice however; that unlike in the case of share company, the law has not governed the general meeting and manager in detail.

<sup>98</sup> Public Enterprise Proclamation No. 25/1992 Art 10

<sup>99</sup> Such question may lack practical importance since even if we conclude that the cooperatives cannot appoint a manager, such does have very little practical effect since the management committee may play policy making and agency role.

<sup>100</sup> Compare Art 24 of Cooperative Society Proclamation No. 147/1998 with Art 362 and 363 of the Commercial Code and Art 14 Public Enterprise Proclamation No. 25/1992 Art 10

<sup>101</sup> Only 24(5) of this provision very slightly implicate the duty of a manager. However; it is insufficient since it does not necessary indicate agency. Also Compare Art 24 of Cooperative Society Proclamation No. 147/1998 with Art 16 of Public Enterprise Proclamation No. 25/1992

<sup>102</sup> Commercial Code Art 33(1) cum Civil Code Art 2203&2204

general meeting to establish subcommittees,<sup>103</sup> it can establish a subcommittee of management committee that can play the role of a manager.<sup>104</sup>

## **B. Powers and duties of different management organs in Ethiopian cooperatives**

As stated above, Ethiopian cooperatives have three management organs. Let us now examine the powers and duties of each organ.

### *General meeting*

The general meeting is the supreme organ. It decides on all matters which are not delegated to other organs by the law, by the by-laws or by its own decisions. Particularly, it makes and amends the by-laws of the cooperative, appoints and controls the management committee and auditors, decides on capital and profit distribution, and dismisses members for disciplinary reasons. It passes these decisions either in an ordinary resolution or in a special resolution. Special resolution is when a decision requires a minimum of two-third majority vote of all members. Other resolutions that require simple majority are ordinary resolutions. Special resolutions are always necessary to amend the by-laws and to amalgamate, divide and convert a cooperative. The by-laws may list additional issues that require special resolution.<sup>105</sup> The general meeting shall be held at least once a year. Emergency general meeting may be held at any time if such is requested by the management committee or one-third of the members or the cooperative agency.

### *Management committee*

The management committee is the think-tank, the record keeper, planner and agent of a cooperative. This is a combination of the powers of the board and general manager in a share company. As discussed in the preceding subtopic, the general meeting may divide these powers and duties and then establish a sub-committee of general managers which can have executive and agency powers and duties. By doing so, the general meeting may in effect establish a board of directors, which may have similarity with a board of directors of share company, which appoints controls and dismisses a general manager. The criteria and procedure of election of members of

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<sup>103</sup> Cooperative Society Proclamation No. 147/1998 Art 27

<sup>104</sup> There is a possibility to have plurality of agents/managers. See Commercial Code Art 237, 288, 525(1) and Civil Code Art 2218.

<sup>105</sup> The listing of contents of the by-laws under Art 11(2) of the Ethiopian Cooperatives Law is by no means an exhaustive list.

the management committee is determined by the by-laws of a cooperative. The term office of a management committee is three years and a person can be elected for membership only for a maximum of two consecutive terms- a person may be elected for more than two terms, provided there is an interval.

#### *Control Committee*

The control committee is equivalent to auditors of companies or public enterprises. Its powers and duties are to audit the performance of the management committee and the books and accounts of the cooperative.<sup>106</sup> The terms of office of the control committee is three years and a member can be elected consecutively only for two terms, and a person may be elected for more than two terms provided there is interval.

### **C. Accountability of the management organs**

The management organs of the Ethiopian cooperatives are accountable to nobody else but to the members. The law puts very little limitations on the freedom of decision of the general meeting which is the supreme organ of a cooperative. This implies that there is high possibility that cooperatives are utilized to maximize profit if the owners are actively participating in the management or otherwise to the personal benefit of the management.

#### *Accountability of the general meeting*

Ethiopian cooperatives law leaves much more freedom to the general meeting than company law leaves to shareholder meetings. For example, the Commercial Code governs shareholder meetings in a more detailed fashion when compared to the Ethiopian cooperative law.<sup>107</sup> All these procedural gaps in the Ethiopian cooperatives law have to be filled either by by-laws or decisions of the general meeting. The Commercial Code fixes the minimum and maximum number of members of board of directors and gives guidelines on the remuneration of the directors.<sup>108</sup> But the general meeting of a cooperative is free to determine the number of directors and their remunerations as it thinks fit. Once again, unlike Ethiopian cooperatives law, the Commercial

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<sup>106</sup> Compare Art 26 of the Ethiopian Cooperatives Law with Art 374 of the Commercial Code.

<sup>107</sup> Compare Arts 388-421 of the Commercial Code with Art 22 of the Ethiopian Cooperative Law

<sup>108</sup> Commercial Code Art 347 and 353



Code also expressly lists persons who could not be auditors.<sup>109</sup> These freedoms may therefore be utilized either to maximize profit or to increase personal benefit of the management committee.

#### *The Management Committee*

The management committee is accountable to the general meeting. It is appointed and removed by the general meeting. It must submit its work plan and activity report to the general meeting for approval. Thus, the management committee, which may include the general manager, may work towards profit maximization when the general meeting is strong enough to control them and at other times work to satisfy their personal interest.

#### *The Control Committee*

The control committee is appointed and removed by the general meeting and accountable to it. The purpose of the control committee is to help the general meeting to control the management committee. However, if the members of the committee are under the influence of the management committee,<sup>110</sup> the cooperative may be driven to the satisfaction of the interest of the management committee.

### **5.3 Conclusion**

In short the Cooperative Society Proclamation No.147/1998 directly and/or indirectly encourages profit-seekers to use cooperative form of economic organization as a competition and profit-maximizing model. This is because the ownership rights in the cooperatives include the rights that are the characteristics of the profit-seeking ownership. Some of the characteristics of the profit-seeking ownership are lender-borrower relationship between owners and the firm, closed membership, investment amount dependent on individual capacity, reinvestment of profit in another profit-seeking firm, trading with non-owners. Moreover; wider ownership rights and accountability of the management organ to the owners are other important characteristics of profit-seeking ownership.

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<sup>109</sup> Ibid Art 370

<sup>110</sup> Members of the control committee may be amateur or relatives of the members of the management committee which make them prone to influence.

These characteristics can possibly exist under the Cooperative Society Proclamation No.147/1998. The lender-borrower relation between owners and the cooperative is possible under the law. This is because the law does not expressly define the type of relationship that should exist between owners and the cooperatives. More importantly; in addition to doing away with principle of open membership and principle of mutuality the law authorizes the sale of shares to investors. The law provides almost for closed membership. This is because, firstly, it gives less attention to the principle of open membership. Secondly, it empowers the founders' general meeting to determine the total number of shares to be sold. Thirdly, it also assumes that there is fixed capital. If the general meeting wants more capital, it would open a door for new membership. Such authority derives the founders to offer membership to persons identified in advance. Fourthly, it mandatorily requires every member to contribute initial capital. Capital contribution may also serve as a means to block the poor from joining the cooperative. Limitation on individual investment capacity is also nominal because such a limitation may be waived if a member is reinvesting the dividend he received from the cooperative and there is no legal mechanism to control nominal members. Trading with non-members and reinvesting in investor owned firm surplus are not prohibited by the law.

Ownership rights are as wide as it is in investor owned firms. The general meeting has the chance to neutralize indivisibility of assets of the cooperative and can keep the legal reserve fund to the bar minimum. Profit sharing is also on the basis of investment. The right to transfer shares is also wide enough. Although the only limitation on ownership rights in cooperatives is voting right such limitation could either be neutralized through lobbying or may even be utilized to the advantage of the majority owners. The power of the general meeting to expel members may also be utilized to widen the ownership rights of the majority. More importantly, and as an extension of wider ownership right, owners are given unrestricted authority to manage the cooperative and to make the management organs accountable to them.

The examination of the law ends here with the conclusion that Ethiopian Cooperative Law merges cooperatives with investor owned firms. The next chapter examines the government policy concerning cooperatives with the same purpose of searching for the criteria that can distinguish cooperative from investor owned firms.

## **CHAPTER SIX**

### **ETHIOPIAN COOPERATIVE POLICY OBJECTIVES**

#### **6.0 Introduction**

By Ethiopian cooperative policy objectives,<sup>1</sup> what is intended here is the ultimate public benefit that the government expects from the cooperatives. Historically cooperatives have been used to attain different objectives such as to reduce the ill effect of capitalism on the working class and small scale producers, to assist the colonial agenda, to facilitate the agenda of ‘land to the tiller’, to transform the rural community into communism, and to reduce poverty.<sup>2</sup> The United Nations encourages cooperatives in sub-Saharan countries as an instrument of poverty reduction and grass root democratizations. As we will see in the following subtopics and chapters of this research, cooperatives may be utilized as instrument for other purposes such as channeling basic goods and creating social solidarity.

As we have seen in Chapter Three, Four and Five although under Cooperative Society Proclamation No.147/1998 cooperatives are very similar to investor-owned firms, they have some special privileges. This Chapter attempts to analyze if the Ethiopian government has any public interest objectives that can justify such special privileges. More importantly; if there is such policy objective it would help us to distinguish cooperative from investor owned.

However; the Ethiopian Government does not have any ultimate objectives that it wants to attain through use of cooperatives. This is inferred firstly from the fact that the Ethiopian Government claims to be a developmental state. Since developmental is authoritarian any objective that may be attained through cooperatives would possibly be attained through the instrumentality of other alternatives such as public enterprises or IOFs. Secondly, although the Ethiopian Government has established a cooperative agency that promotes and supports cooperatives, there is no clear direction set by the Government that guides the cooperative agency and other Government

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<sup>1</sup> The “objective” may mean three different but interrelated things: mission, goal and vision. However; in this sub-topic it is intended to mean vision. For further discussion see chapter three

<sup>2</sup> See Chapter One

organs. As a result there have been misunderstandings between the cooperative agency and other government agencies as to the goal of cooperatives. The fact that the objectives that cooperatives are intended to attain can also be attained by public enterprises and investor-owned firms has exacerbated the disagreement around the goals of cooperatives.

These conclusions are drawn from a number of sources. These include a review of the agricultural policies of Ethiopia which claim to contain the ultimate objectives of agricultural cooperatives and interviews. The analysis begins by trying to pinpoint the place of cooperatives in democratic developmental state political economy.

## **6.1 Cooperatives in the theory of developmental state**

In developmental state ideology, the place of a true cooperative is invisible due to the soft nature of freedom of association and the legitimacy and power of the state in its use of a carrot-and-stick approach to enhance the private sector that could lead to economic development. Such a state has unlimited power to interfere in the economy and limit property rights and the freedom of contract. Thus, it can attain any of its economic objectives through public enterprise/investor-owned firms. The Ethiopian state claims to be developmental.

The state is said to a developmental state if it fulfills at least two criteria. The first criterion is that the Government believes that its ultimate responsibility is bringing economic development.<sup>3</sup> This means national economic development is part of its ideology.<sup>4</sup> A state embraces this approach in part when considering the power which other states wield internationally as result of their economic strength. So, in order to win international influence and importance, developmental states decide to boost their economy at the expense of other objectives. It is ready to make any sacrifices if that would lead to economic development. The most obvious things that

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<sup>3</sup> See Meles Zenawi, 'State and Market: the Neoliberal limitations and the Case for a Developmental State' in Akbar Norman, Kwesi Botchwey, Howard Stein, and Joseph Stiglitz, *Global Growth and Governance in Africa: rethinking development strategies* (Oxford University Press, 2012) 167. Meles Zenawi, up until he died in August 2012 was the leader of the ruling party and the prime minister of Ethiopia. He is often accredited as being the mastermind behind the modern developmental state movement in Ethiopia.

<sup>4</sup> Social issues such as poverty reduction, fair wealth distribution, and, welfarism are only secondary agendas at best. The underlying objective of developmental state is to increase the share and the benefits earned (gained) from the global economic integration with an ultimate goal of becoming an industrialized country.

a developmental state is ready to sacrifice are democracy and individual rights.<sup>5</sup> The government gets popular support by appealing mainly to nationalism and national patriotism<sup>6</sup> instead of individual rights and democracy.<sup>7</sup>

When we see the place of cooperatives in a liberal political economy, they are enabled by an individual's freedom of association. In communitarian ideology, cooperatives may be used as a springboard to create an egalitarian society. Developmental state ideology does not necessarily guarantee freedom of association. Moreover, it has no ultimate objective for creating an egalitarian society. So it is difficult to place true cooperatives in developmental state ideology. The only point where true cooperatives would be envisaged in a developmental state ideology is as a means of creating the social capital necessary for economic development.<sup>8</sup> Or, as we will see in the following paragraphs cooperatives may be solely the result of economic choice which make them the same with investor-owned firms or public enterprises. That may be the case why Japanese cooperatives are concentrated in agriculture, saving and credits and retail distribution of food which is unparalleled by the United States or other industrialized Western countries.<sup>9</sup>

The second criteria that show us that the state is a developmental state is the extent of autonomy the government has to decide and implement its ideology.<sup>10</sup> Developmental state government is politically unlimited government. It has legitimate power to limit individual rights and to interfere in the economy. But unlike communitarian states, the developmental state does not necessary involve itself in the production and distribution of goods and services. Rather it may

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<sup>5</sup> Meredith Woo-Cumings (ed), Introduction: Chalmers Johnson and the Politics of Nationalism and Development (Cornell University Press, 1999) 17-20

<sup>6</sup> An appeal to the necessity of economy for the protection of other individual and democratic rights may also be made. This means developmental state may also partially borrow the argument of communitarians who says that without economic equality there would not be political equality. This seems to be one of the justification the Ethiopian government is appealing to since it is not easy for this government to appeal to nationalism and national patriotism since it was a secessionist rebel group twenty five years before and it still adheres to ethnic federalism.

<sup>7</sup> Woo-Cumings (n 5) 8

<sup>8</sup> The French and Belgian Model of Cooperatives in Colonial Africa could be an indicative of the possibility of using cooperatives to create social capital. See Frederick Wanyama, 'Reinventing the wheel? African cooperatives in liberalized economic environment '(2009): *Annals of Public and Cooperative Economics* 80(3) 361. Proponents of developmental state ideology believe that social capital is a critical factor in economic growth and development. See Zenawi (n 3) 148

<sup>9</sup> See Mark Klinedinst and Hitomi Sato, 'Japanese Cooperative Sector' (1994) 28(2) *Journal of Economic Issues* 509 Japan has been a developmental state where as United State has been a liberal state and Western Europe has been mainly partly liberal and partly communitarian.

<sup>10</sup> Zenawi (n 3) 167

limit itself to directing private investors towards an economic activity that contributes to national economic development such as import-substitution industries, export trade, innovation and agricultural activities. It uses a carrot-and-stick approach to guide investors to economic activities. The developmental state is also autonomous from public opinion. It has also efficient bureaucracy composed of very qualified professionals, competent and obedient military and police force. In short it has the legitimacy and power to implement its economic ideology.

Thus, the fact that the state can direct investor-owned firms to whatever objectives it desires that ultimately leads to economic growth, cooperatives in their proper sense become of no use. Although the state may allow investors to organize their business in a cooperative form, as far as the state believes that such organization can lead to economic development, since the central aim of the developmental state is that of nurturing and enhancing private sector enterprises on the basis of profit maximizing agenda that represents the country in the international market it need not bother about true cooperatives. Even more, its objective in creating competent profit-maximizing investor-owned firms squarely contradicts the goal of true cooperatives. Finally, the nature of true cooperatives is autonomy but the interventionist nature of developmental state leaves very less room for such autonomy.

## **6.2 Ethiopian cooperative policy objectives**

This subtopic intends to show that the Ethiopian Government does not have cooperative policy that justifies special cooperative privileges recognized by the Cooperative Society Proclamation No 147/1998. There is no express cooperative policy objective. But that may not necessarily lead us to conclude that there are no cooperative policy objectives. The policy objectives might have been impliedly incorporated in various documents such as Agricultural Cooperatives Sector Development Strategy 2012-2016 and the Growth and Transformation Plan, 2010. On the basis of these documents some cooperative policy objectives such as providing alternative product/input market to smallholder farmers and pastoralists, channeling basic goods, saving and credit alternatives and poverty reduction could be conjectured. However, such objectives are apparent (not serious commitments). This is because; first, the government can use or has been

using other alternatives for the same purpose. Secondly, there has been confusion on what is claimed to be a cooperative policy.

### **A. Systemic intervention in the agricultural sector of the economy.**

Agriculture is an engine for economic development in Ethiopia. The Ethiopian Government has planned to achieve lower middle income status by 2025.<sup>11</sup> The Ethiopian Government takes agriculture as an engine of economic growth and transformation. That is the agricultural sector continues to be the major source of economic growth. The economy has to grow primarily in the agricultural sector and such growth should propel the industrial sector to grow.<sup>12</sup> The agricultural sector is given this priority importance since it is believed that its growth ensures relatively cheap labour by keeping food items similarly cheap. It also means that there would be relatively cheap and quality raw material for the industries. Normally industrialization is expected to begin from small agro-processing industries such as food, leather, and textile factories and then transform to medium level and finally to large scale manufacturing. Since about 85% of the Ethiopian population lives on agriculture, the increase in the income of peasantry/pastoralists increases market opportunity for industrial output, and even investment capital. More importantly since developmental state theory prioritizes export and since the export commodities of Ethiopia are agriculture products such as coffee, sesame, nut, ‘*chat*’<sup>13</sup>, flowers, cotton, hides and skins, agriculture helps the industry to grow by enabling the country to earn sufficient foreign exchange. These agricultural products except flower and cotton are produced by small holder farmers/pastoralists. The agricultural development-led industrialization strategy focuses on small holder farmers/pastoralists’ need to increase production and productivity.<sup>14</sup>

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<sup>11</sup> Ministry of Agriculture, ‘Agricultural Cooperatives Sector Development Strategy 2012-2016’ (2012<[http://api.ning.com/files/464c0NtXZtDs3-DGp0RziNVQaTPSSRO\\*4np2q7x0UaI4G1PRQeVzXmIf6zNOXGAR8-xiqLonmmmlpW-RwUedIEmMdP5qED0b/AgriculturalCooperativeSectorDevelopmentStrategy201220163.pdf](http://api.ning.com/files/464c0NtXZtDs3-DGp0RziNVQaTPSSRO*4np2q7x0UaI4G1PRQeVzXmIf6zNOXGAR8-xiqLonmmmlpW-RwUedIEmMdP5qED0b/AgriculturalCooperativeSectorDevelopmentStrategy201220163.pdf)> accessed 30 January 2015, 4

<sup>12</sup> This is on the assumption that underdeveloped countries do not have any better alternative than gradually transforming their economy from agriculture to industry.

<sup>13</sup> ‘Chat’ is a green mind stimulant plant.

<sup>14</sup> Ministry of Finance and Economic Development, ‘Growth and Transformation Plan of 2010’ (2010) <<http://www.mofed.gov.et/English/Resources/Documents/GTP%20English2.pdf>> accessed 30 January 2015, 21.

Consumers/agro-processors may also be forced to buy at very high price. Besides creating market injustice, the low price to farmers/pastoralists would discourage them from producing sufficient quantity and quality products.<sup>15</sup> The soaring price of food may also increase the price of labour and the agro-processing industries may be unable to get sufficient quantity and quality product at competitive prices. In addition, this market failure also invites unnecessary trade chains and costs since the traders may be less interested in economizing transactions. The individual farmer/pastoralist may be unable to search for alternative markets due to economy of scale and lack of information. That is probably why the growth and transformation plan is intended to strengthen the agricultural marketing system.<sup>16</sup>

In addition to the abuse of market dominance by traders some farmers/pastoralists are also prone to manipulation. The intermediaries or even the trader may exploit the manifest business inexperience of farmers/pastoralists. The Ethiopian farmers/pastoralists have very less access to market information and also do not have the requisite marketing skills. The traders have experience in cheating farmers and pastoralists especially coffee producers by such means as issuing cheques without sufficient cover. This cheating has been committed both with and without collaboration of banks. The banks may collaborate with the cheaters by refusing to give evidence that shows that the cheque has been presented in due time but has not been paid.<sup>17</sup>

In addition to economic issues, enabling farmers/pastoralists to obtain an equitable share of the national wealth commensurate with their contribution is a constitutional duty of the Government.<sup>18</sup> The Ethiopian farmers/pastoralists have the right to receive fair prices for their products so that their life would be improved proportionate to the overall economic development

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Ministry of Finance and Economic Development released in September 2010 the five years economic development plan that runs from 2010/11-2014/2015. This Plan is abbreviated to ‘GTP.’

<sup>15</sup> Although low domestic market price of exportable agricultural products may temporarily encourage exports since such low prices would make the exporter more competitive in the international market, the export becomes sustainable if the farmers/pastoralists are encouraged to continue produce further.

<sup>16</sup> Ibid

<sup>17</sup> Commercial Code 1960 <<http://www.wipo.int/edocs/lexdocs/laws/en/et/et014en.pdf>> accessed 30 January 2015, Art 868

<sup>18</sup> Constitution of the Federal Democratic Republic of Ethiopia 1994

<[http://www.wipo.int/wipolex/en/text.jsp?file\\_id=193667](http://www.wipo.int/wipolex/en/text.jsp?file_id=193667)> accessed 30 January 2015, Art 41(8)



of the country.<sup>19</sup> These objectives are guiding principles of economic and social policies.<sup>20</sup> That means the Government must make sure that the benefits of economic and social developments of the country never unfairly go to the urbanites. As a constitutional duty, the Government has to identify challenges to the agricultural sector and provide necessary support if the sector is to produce the expected results. One of the major problems of smallholder farmers/pastoralists in Ethiopia is the lack of alternative markets. This may be due the existence of the few traders who buy agricultural products. The fact that there are few buyers of agricultural product further means that there are few suppliers of these products to the final consumers or agro-processors. Thus these few traders buy and resale agricultural products at a price they think right. As a result the farmers/pastoralists receive a very low price.

Therefore, the Government has planned to interfere into the agricultural sector of the economy by using agricultural cooperatives.<sup>21</sup> “Agricultural cooperatives are agricultural-producer-owned cooperatives whose primary purpose is increasing member producers’ production and income by helping better link with finance, agricultural inputs, information, and output markets.”<sup>22</sup> They are seen as critical in achieving the Government’s development targets in GTP.<sup>23</sup> It is believed that a “well-functioning agricultural cooperative sector helps many smallholder farmers increase their yields and incomes.”<sup>24</sup> These agricultural cooperatives would be agricultural output marketing cooperatives and agricultural input supplying cooperatives.

The Government would therefore use agricultural cooperatives to solve agricultural output market problem and to disseminate agricultural technologies to smallholder farmers and pastoralists. Let us see these two options in some detail and we also consider if the Government has other alternatives.

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<sup>19</sup> Ibid

<sup>20</sup> Ibid

<sup>21</sup> Ministry of Agriculture (n 11) 7

<sup>22</sup> Ibid 7

<sup>23</sup> Ibid

<sup>24</sup> Ibid 4

### **Alternative market to smallholder farmers and pastoralists**

In order to solve the output marketing problems of agricultural outputs farmers and pastoralists may be encouraged by the Government to form marketing cooperatives. The cooperatives would purchase the products of their member at a fixed price and then resell them to consumers and agro-processors in the domestic and international market. The cooperatives, therefore, act as a commission agent for each member. The Growth and Transformation Plan of 2010 provides as follows:

*“Since it is essential to make the agriculture marketing system remain in tune to the agricultural production and productivity growth, and since this system is essential for accelerated agriculture growth, focus will be made to lay down an agricultural marketing system starting at kebele all the way up to country level. Transparent, efficient and effective agricultural marketing system that involves farmers’ cooperatives...will be established and strengthened.”*<sup>25</sup>

Of course, the problem of agricultural marketing could be resolved through other alternatives such as agricultural products standard and quotes (fixing the standard quality with corresponding prices), public enterprises (wholly state owned business enterprises that buy agricultural products from peasants/pastoralists and supplies agricultural inputs) and commodity exchange markets (a public enterprise that serve as intermediary between the peasant/pastoralists and traders). The Growth and Transformation Plan does not see cooperatives as the only alternatives to solve agricultural problems.<sup>26</sup> The Growth and Transformation Plan also expects that modern output market centers and the private sector will be established and strengthened.<sup>27</sup> Generally, it is difficult to see the special role of cooperatives in agricultural marketing in the context of a political economic system where the state can interfere in a market without limit to ensure that the market functions efficiently. Historically agricultural marketing cooperatives emerged in a political economy where the state was unable or unwilling to directly interfere in the economy.<sup>28</sup>

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<sup>25</sup> Ministry of Finance and Economic Development (n 14) 23 (emphasis added)

<sup>26</sup> Ibid

<sup>27</sup> Ibid

<sup>28</sup> See the emergence of Producers’ Cooperatives in Nineteenth Century North America in Chapter One.

As stated above, the Ethiopian Government may correct the agricultural product market failure in at least three alternative ways. The first alternative is to establish wholly state owned agricultural commodity exchange market institutions.<sup>29</sup> In this regard the Growth and Transformation Plan provides as follows:

*“The shift to a higher growth path of agricultural diversification and commercialization of subsistence agriculture also requires an effective marketing system. Modern agricultural marketing system like the marketing practiced through ECX will be made to continue with strength.”*<sup>30</sup>

The Ethiopian Commodity Exchange (the Exchange) was established in 2007 by the Government to solve the market problems that affects agricultural produces. Through this it was hoped that the establishment of orderly and unified marketing system for agricultural commodities would increase the participation of small agricultural producers by providing up-to-date market information and enabling them to negotiate better prices for their products.<sup>31</sup> Furthermore, the farmers and pastoralists would be guaranteed payment of the sale price by the market institution.<sup>32</sup> Since the Exchange would serve as an intermediary the cost of transaction would also be reduced.

However, the Exchange may be inaccessible for individual small holder farmers and pastoralists. The first reason is that the right to trade on the Exchange belongs to members only.<sup>33</sup> It would be inconvenient for ordinary and illiterate<sup>34</sup> Ethiopian farmers and pastoralist to fulfill membership criteria and then purchase membership seats.<sup>35</sup> Secondly the Exchange is open only for few cash crops such as coffee and sesame. Thirdly, the Exchange is available only in a few places. Thus, cooperatives would still remain important for marketing agricultural produces. But still there is a second alternative that may make cooperatives unnecessary.

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<sup>29</sup> Ethiopian Commodity Exchange Proclamation No.550/2007

<<http://www.ecx.com.et/downloads/Rules/ecexproclamation.pdf>> accessed 30 January 2015, Art 3(1)

<sup>30</sup> Ministry of Finance and Economic Development (n 14) 29

<sup>31</sup> Government of Ethiopia (n 29) Preamble and Art 6

<sup>32</sup> Ibid Art 6(6) and 9(2)(e)

<sup>33</sup> Ibid Art 20(1)

<sup>34</sup> More than half of the population of Ethiopia is unable to read and write.

<sup>35</sup> Government of Ethiopia (n 29) Art 8

The second alternative would be standard and quotes,<sup>36</sup> complemented by licensing and concession agreements. The Government may determine the quality and quantity standard of agricultural products.<sup>37</sup> Then based on the standard it is possible to quote price for each agricultural products. The Government may further regulate the market by issuing special trade licenses to those grain dealers who fulfill certain criteria<sup>38</sup> necessary for fair and efficient agricultural marketing including ethical criteria. These traders may also be made subject to government inspection and supervision. When the government wants to give some subsidies to small holder farmers/pastoralists it may enter into a concession agreement with traders. The concession agreement may then entitle the smallholders to a higher price from the trader and the trader being compensated by the Government.<sup>39</sup> The purchase price quote would possibly force the traders to increase efficiency and avoid unnecessary middlepersons. The standardization measures may also have side benefits of pushing the farmers/pastoralists to produce products that meet the quality demand of international market and hence complement the export trade of the country. However, this alternative may be impracticable since standardization<sup>40</sup> would be costly and time taking and cooperatives may still remain important.

The third alternative is establishing an autonomous public enterprise<sup>41</sup> that purchases agricultural producers of smallholder farmers/pastoralists.<sup>42</sup> The developmental state by definition is a state whose government would take all possible measures that would contribute to the economic development. Besides, the Privatization and Public Enterprise Supervising Authority has the

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<sup>36</sup> B.H. Hibbard, 'Effect of Government Control on Marketing Methods and Costs' (1919) 9(1) The American Economic Review 50

<sup>37</sup> Quality and Standards Authority of Ethiopia Establishment Proclamation No. 102/1998  
<<http://chilot.me/2011/08/07/proclamation-no-1021998-a-proclamation-to-establish-quality-and-standards-authority-of-ethiopia/>> accessed 30 January 2015

<sup>38</sup> The license criteria may include cooperative form of ownership if necessary.

<sup>39</sup> Civil Code 1960 <<http://onebookonevote.com/ethiopian/ethiopian-civil-code-1960-pdf.html>> accessed 30 January 2015, Art 3207-3243.

<sup>40</sup> Standardization means an activity which consists of processes of formulating, issuing and implementing standards. Ibid Art 2(3)

<sup>41</sup> Notice that Ethiopian Commodity Exchange is also a public enterprise. However; its role is the role of a brokerage or intermediary. It does not buy or sell agricultural produces.

<sup>42</sup> Ministry of Agriculture (n 11) 48 In Ethiopia, during the Derg regime, there was a Government agency that purchased agricultural products and resold them to the urban dwellers. However, the purpose was controlling the price of agricultural produces in favour of the urbanites rather than protecting the peasantry. Currently also there is the Ethiopian Cereal Grain Enterprises that purchases cereals in order to ensure that the country would have sufficient reserve cereals for a time of any emergency.

power to “cause the establishment of new enterprises in sectors where private investors could not participate for various reasons and which would be bottleneck for the overall economic development.”<sup>43</sup> Thus, the Ethiopian government may establish a public enterprise whenever required. The enterprise purchases agricultural produces at a price determined by the management from time to time depending on the type and quality of the product. Public enterprise would obviate the need of standardization. Since its ultimate objective is to help the farmers and pastoralists it would not deprive them of their produce. The purpose of standardization is to make sure that the traders are paying fair price to the agricultural producers.

### **Medium of agricultural technology dissemination**

Agriculture is essential to the Ethiopian economy. But the challenge it faces is not only marketing of output but also marketing of inputs. “It is proved that it is possible to increase the productivity of smallholder farmers within short period of time by utilizing...technologies.”<sup>44</sup> The Government plans to make the increase in productivity of smallholder farmers the basic sources of agricultural growth.<sup>45</sup> Thus, to increase agricultural productivity farmers/pastoralists will be given in new technology adoption.<sup>46</sup> However, the market may not ensure the supply of the required technology at required time and price. In order to sustain technology use, government may be expected to take measures to make farmers have enough inputs.<sup>47</sup> Thus, the Government may engage in tasks to distribute technology efficiently by using farmer cooperatives.<sup>48</sup>

But there are no sufficient reasons behind the preference of cooperatives over other forms of economic organization. Probably cooperatives may make concerned farmers and pastoralists active participant in the supply of the technology. In fact, if the cooperatives are true cooperatives both in the sense that they do not have profit maximizing motives and in the sense that each member joins the cooperatives without direct or indirect influence either apparent or

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<sup>43</sup> Privatization and Public Enterprise Supervising Authority Establishment Proclamation No.412/2004 <[http://69.94.35.190/bid/2005/dec05/dec\\_10\\_privatization\\_and\\_public\\_enterprise\\_supervision\\_agency.htm](http://69.94.35.190/bid/2005/dec05/dec_10_privatization_and_public_enterprise_supervision_agency.htm)> accessed 30 January 2015, Art 5(3)

<sup>44</sup> Ministry of Agriculture (n 11) 44 (emphasis added)

<sup>45</sup> Ministry of Finance and Economic Development (n 14) 22

<sup>46</sup> Ibid

<sup>47</sup> Ibid 23

<sup>48</sup> Ibid (emphasis added)

real<sup>49</sup> from the Government, they would reduce the burden of the Government. But when cooperatives are established by the initiation of the Government there would be passivity on the part of members. This means the Government still remains burdened in organizing, supporting, inspecting and privileging the cooperatives. After all these efforts, they may not produce the expected result. Furthermore, the ongoing inefficiency may lead the Government to interfere in the autonomy of the cooperatives.<sup>50</sup> Compared to cooperatives public enterprises would be efficient. The Government may also define agricultural inputs and technologies as basic goods and accordingly regulate the distribution of such basic goods by investor-owned firms.<sup>51</sup>

## **B. Consumer Protection, Saving and Poverty**

The government may also interfere in non-agricultural sectors of the economy. This may be to protect consumers or encourage saving or reduce poverty. Let us examine these points in some details as follows:

### **Medium of Channeling Basic Goods/Services to the Consumers**

“The term ‘Basic Goods or Services’ mean goods or services related to the daily need of consumers, the shortage of which in the market may lead to unfair trade practice.”<sup>52</sup> Sugar, bread, edible oil, wheat, *teff*<sup>53</sup>, and soap are examples of basic goods.<sup>54</sup>

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<sup>49</sup> The apparent influence is the propaganda of local cadres that creates psychological influence on farmers/pastoralists. The cadres may make the farmers/pastoralists believe that if they do not join cooperatives they would be taken as disobedient to the Government which may have a negative repercussion that they could not know what. The real influence is when the farmers/pastoralists are intentionally denied by the Government to access to technology through their own ways.

<sup>50</sup> We will see in the next Chapter that cooperatives have been proved inefficient in enabling the Government to attain the expected result.

<sup>51</sup> Compare this with Trade Practice and Consumers’ Protection Proclamation No. 685/2010 <<http://chilot.me/2011/01/19/trade-practice-and-consumer-protection-proclamation-no-6852010/>> accessed 30 January 2015, Art 2(1) and 47

<sup>52</sup> Trade Practice and Consumer Protection Proclamation No. 685/2010 <<http://chilot.files.wordpress.com/2011/01/685-ae.pdf>> accessed 30 January 2015, Art 2(1)

<sup>53</sup> A tiny cereal used to prepare traditional bread called *injera*.

<sup>54</sup> Since the law does not contain lists of basic goods it is either up to the Ministry of Trade or Council of Ministers to determine the list. Health, electric, water and telecommunication may be outside of the definition of basic goods/services since such services are currently provided by the government and hence they are less likely to lead to unfair trade practices. See Proclamation No. 685/2010 (n 72) Art 2(1), 46 and 55 “The term ‘Consumer’ means a natural person who buys goods and services for his personal or family consumption, where the price is being paid by him or another person and not for manufacture or resale” Art 2(4)

Besides its unjustness, unfair trade practice<sup>55</sup> would affect the development agenda at least in two ways. Firstly, it may lead to price soaring, thereby making basic goods/services out of the reach of those in need.<sup>56</sup> In addition to affecting the political stability which is essential for development, price soaring would affect the industrializations by increasing labour price. It may also lead to inflation which could have destructive consequence over the economy.<sup>57</sup> The Growth and Transformation Plan considers high inflationary pressure a serious challenge to the macroeconomic stability and intends to keep it within a single digit.<sup>58</sup> Secondly, unfair trade practice leads to socially wasteful rent-seeking.<sup>59</sup> Capital would flow to areas where large profit would be reaped without however; adding any value to the economy. Value adding areas of investment such as manufacturing would be relegated as unprofitable. In short, the Government has a keen interest to fight unfair trade practices.

Promoting producer and consumer cooperatives and assisting them would be one alternative of fighting unfair trade practices.<sup>60</sup> The Government may assist smallholder farmers/pastoralists to be organized into marketing cooperatives to supply their produces directly to the consumer. This would be made complete by assisting consumers of agricultural producers to be organized into purchasing consumer cooperatives. This coordination of the rural with the urban would reduce cost of transactions by abolishing intermediaries and by benefiting from economies of scale. This strategy would also connect consumers (in this case rural or urban consumers) to manufacturers. The Government could also use consumer cooperatives to distribute imported basic goods. There is a public enterprise, the Wholesale and Import Enterprise, which has the duty to import basic goods and make them available to retailers. During the socialist government, the Wholesale and Import Enterprise and Ethiopian Grain Enterprise were using the lowest administrative organ (*kebele*) to distribute basic goods to consumers. However, the introduction of the market economy outdated the importance of *kebele* as an alternative means of channeling basic goods. Consumer cooperatives could perform the role once perform by the *kebele*.

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<sup>55</sup> The law defines unfair trade practice to mean ‘any act in violation of provisions of trade related laws’ see Ibid Art 2(12). However, the researcher uses it here to mean any benefit that the trader derives due to absence of competitive market.

<sup>56</sup> Tony Cleaver, *Economics: the basics* (2<sup>nd</sup> edition, Routledge, 2011) 103

<sup>57</sup> Jim Stanford, *Economic for Everyone: A Short Guide to the Economics of Capitalism* (Pluto Press, 2008) 202

<sup>58</sup> Ministry of Finance and Economic Development (n 14) 3 and 16

<sup>59</sup> Zenawi (n 3) 48

<sup>60</sup> See Proclamation No. 685/2010 (n 72) Art 47

However, there are other options to control unfair trade practices. One of these options would be to control situations that would lead to market abuse such as cartelisation.<sup>61</sup> Price cap could also be applied to complement the antitrust law. The Ministry of Trade and regional bureaus are empowered by the law to prepare the list of basic goods/services with price caps and make it known to the public.<sup>62</sup> The Ministry/bureau would also follow up the implementations of its notices by a trader.<sup>63</sup> Establishing public enterprise that carryout retail trade of basic goods/services would also be another option.

### **Saving and credit alternatives**

One of the major challenges to the Ethiopian economy is the low level of domestic savings to support the huge demand on the country's investment for accelerating growth and development.<sup>64</sup> It is feared that such a low level of domestic savings would hinder the success of the Growth and Transformation Plan.<sup>65</sup> To avert such problems "everything possible will be done during the GTP period to fully utilize domestic opportunities through community/social mobilization; and to coordinate efforts with non-state actors in general in order to tap the dynamic potential of Ethiopian society."<sup>66</sup>

Saving and Credit Cooperatives would be one alternative ways of engaging the community and achieving the social mobilization through non-state actors. Banks are usually inaccessible to rural communities and even to low income urban residents. Thus local saving and credits cooperatives could be promoted by the Government to fill this gap. In addition, to serving inaccessible places, they could actively promote saving.

However, saving and credit cooperatives would not be the best way for the Government to promote and access savings.<sup>67</sup> This is because the savings deposited in saving and credit cooperatives are mainly out of the reach of the Government. It is difficult for the Government to

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<sup>61</sup> Ibid Art 5-22, 49

<sup>62</sup> Ibid Art 46

<sup>63</sup> Ibid Art 47

<sup>64</sup> Ministry of Finance and Economic Development (n 14) 3

<sup>65</sup> Ibid 96

<sup>66</sup> Ibid 98 (emphasis added)

<sup>67</sup> Although the Government has developed a strategic plan to use agricultural cooperatives to increase smallholder farmer yields and income, and although rural saving and credit cooperatives are owned by farmers and can help increase yield and income, the strategic plan does not include them. See Ministry of Agriculture (n 11) 7



supervise the money that flows in the economy through the medium of the saving and credit cooperatives. Moreover, the Government would find it difficult to direct the use of such money to projects given priority by the Growth and Transformation Plan.<sup>68</sup> Saving and credit cooperatives extend loans to members with very less regard to the type of project for which the money is intended to be used. Thus, the Government has preferred to make Government-owned banks especially the Commercial Bank of Ethiopia and small and micro financial institutions accessible to the people. In addition, the Government is using government bonds and housing savings as an alternative way to promote savings. Although saving and credit cooperatives would be feasible alternative ways of gaining loans for household/smallholders<sup>69</sup> since they do not normally require collateral as banks do, the Growth and Transformation, does not indicate any plan of the government to solve the problem of smallholders' access to loan.

### **Poverty reduction strategy**

It has been the Millennium Development Goal of the UN to reduce poverty by half in 2015. Ethiopia as a member of the UN and also as a country aspiring to reach middle level income in 2025 has planned to reduce poverty. Poverty may be reduced in three alternative ways. The first alternative is to enable an individual to participate in an economic activity that earns them enough money. They may be assisted either to get employment or to start to improve their own enterprise. In addition, to reducing poverty, this alternative also contributes to the general economic development of the country. The second alternative is providing financial aid and other benefits to an individual in poverty. Although this alternative reduces poverty, it adds nothing to the economy and may even lead to dependency and waste labour resources. A combination of both alternatives may be used as a third alternative.

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<sup>68</sup>About the government's plan to prioritize projects see Ministry of Finance and Economic Development (n 14) 17-18

<sup>69</sup> Banks are usually unwilling to extend loan to smallholders either because of expensive cost of administering spatially dispersed small loans or smallholders especially peasants could not develop acceptable project proposal or they could not have collateral to guarantee the repayment of the loan. The problem of collateral is more severe for Ethiopian smallholder farmers since land is a public property and a peasant holder has no right to present it as collateral. See Constitution of the FDRE (n 15) Art 40(3)-(5); Federal Democratic Republic of Ethiopia Rural Land Administration and Land Use Proclamation No.456/2005 <<http://theredddesk.org/printpdf/countries/laws/federal-democratic-republic-ethiopia-rural-land-administration-and-land-use>> accessed 30 January 2015, Art 8

Cooperatives could be used to combine both poverty reduction strategies. The United Nation also recommends cooperatives to be used to reduce poverty.<sup>70</sup> There is precedent for this as historically, cooperatives emerged in nineteenth century Britain to reduce the poverty of people affected by capitalist economy. Philanthropists have employed cooperative form of economic organizations to fight poverty especially in Southeast Asia.<sup>71</sup> Thus, the Government may organize poverty-stricken individuals into producer/worker cooperatives, provide them with necessary training, and give them working capital including working premises and moral support. The Government may also provide the members of the cooperatives with subsidized basic goods/services. The cooperatives could be organized to gradually grow out of their dependence on state subsidy provided their members have come out of poverty.

However, the Ethiopian Government prefers to use micro and small enterprises rather than cooperatives to reduce poverty. An enterprise is classified into micro and small enterprise solely on the basis of capital and does not make any distinction between cooperatives and other forms of micro and small enterprises (sole trader, or business organization proper).<sup>72</sup> The government subsidizes micro and small enterprises providing comprehensive and accessible development support such as training, access to loan, working premises and market opportunity.<sup>73</sup> Hence, the Government has seen nothing special in cooperatives in struggle against poverty.

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<sup>70</sup> Johnston Birchall, *Rediscovering the cooperative advantage: poverty reduction through self-help* (Cooperative Branch of International Labour Office, 2003)

<sup>71</sup> See Chapter One

<sup>72</sup> Ministry of Finance and Economic Development (n 14) 31

<sup>73</sup> Ibid

## 6.3 The Confusion about cooperative policy objectives

Although the Federal Cooperative Agency was established in 2002 to register and support cooperatives<sup>74</sup> and although the Agricultural Transformation Agency has developed Agricultural Cooperatives Sector Development Strategy from 2012-2016 it is still unclear what the Government expects from cooperatives. There is even a suspicion that the Government has no policy objectives to attain through its use of cooperatives and it is up to the middle level management to redirect the cooperatives to solve any contemporary problem. The following points indicate where this confusion lies.

### A. No policy objectives but strategy

There is confusion of between policy and strategy. As stated in the beginning of this chapter, the cooperatives policy objective is the ultimate public benefit that the Government expects from cooperatives. On the other hand, the strategy is intended to mean the practical guidelines that have to be followed and actions that have to be taken in order to attain the policy objectives.<sup>75</sup> Accordingly, to develop a strategy there should first be policy objectives. The Ethiopian Agricultural Transformation Agency has developed Agricultural Cooperative Sector Development Strategy that is expected to enhance the Government's support of agricultural cooperatives.<sup>76</sup> The agency identified seven bottlenecks that affect the well-functioning of the agricultural cooperatives and laid down actions that the Government is expected to take to resolve the bottlenecks.<sup>77</sup> One of the seven bottlenecks identified by the agency is the lack of policy objectives.<sup>78</sup> However, paradoxically, the Agency states that the policy objective of the agricultural cooperatives is to increase smallholder farmers' productivity and income.<sup>79</sup> Probably the agency entered into such an erroneous assertion because it is impossible to develop a strategy without identifying policy directions. However, rather than conclusively stating the

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<sup>74</sup> There are regional cooperative agencies responsible to register and support cooperatives established in their respective regions. The Federal Cooperative Agency registers cooperatives whose members are from more than one region. However, the jurisdiction of support does not seem to be limited to the cooperatives registered in the federal level as far as the agency has the capacity to do so although it seems reasonable to expect that the federal cooperatives should be given priority. See Cooperative Commission Establishment Proclamation No.274/2002 <<http://www.fsc.gov.et/resources/Negarit%20Gazeta/Gazeta-1994/Proc%20No.%20274-2002%20Cooperatives%27%20Commission%20Establishment.pdf>> accessed 30 January 2015, Art 5

<sup>75</sup> Ministry of Agriculture (n 11) 13

<sup>76</sup> Ibid 5

<sup>77</sup> Ibid

<sup>78</sup> Ibid

<sup>79</sup> Ibid 4

policy objective that does not exist, the agency should have at most expressly stated that it has been making assumption of policy objective. In fact, the wisest alternative open to the agency was to keep aside its plan of developing strategy for the time being and concentrate on ascertaining the policy objectives. Thus the agency has been confused.<sup>80</sup>

## **B. Lack of consensus on cooperative policy objectives**

The confusion over what are the policy objectives of cooperatives is further evidenced by their different treatment by different state organs. . For example, the Ministry of Trade has refused to allow cooperatives to function without business licenses.<sup>81</sup> Similarly the Ministry of Revenue and Custom Authority has been forcing the cooperatives to pay income tax as if they are investor-owned firms.<sup>82</sup> Paradoxically, the Ministry has refused to recognize cooperatives as investors.<sup>83</sup> The Ministry of Transport has recently classified cooperatives into category of Charities and Societies (Non-profit making associations) while registering vehicles.<sup>84</sup> The Addis Ababa City Administration Trade and Industry Bureau does not make any distinction between cooperatives and investor-owned firms in the incentives it extend as far as both are within the maximum capital ceiling of micro and small scale enterprises.<sup>85</sup> Moreover, the City Administration has been encouraging peoples to form a “consumer” cooperative society which purchases subsidized basic goods from the City Administration and resells them to consumers at

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<sup>80</sup> It may even be claimed that the cooperative policy objective indicated in the Agricultural Cooperative Sector Development Strategy is a mere assumption that the Agricultural Transformation Agency has made without any express support from the government. The first point that supports this claim is the fact that the Strategy was written mostly on the basis of literatures and domestic and foreign experiences. Government sources are referred only on overall performance of Ethiopian economy and Ethiopian cooperatives. See endnotes of the Strategy. Although it is true that the government has strong commitment to support and promote cooperatives, the Growth and Transformation Plan, nowhere indicates that they are key pathway by which the agriculture sector and the economy as a whole will develop over the next five years and beyond (Compare end note no.12 of the Strategy). Secondly, although the Federal Cooperative Commission has developed a project by buying consultancy service from UKCC to open Cooperative College it is not clear whether the government would agree and assign necessary budget. See Ato Michael Ayele, ‘Interview with Senior Legal Expert of the FCA’ (2014) unpublished

<sup>81</sup> Ibid

<sup>82</sup> ከ ዲ.ኤስ.ዘ.ዘ. 73ኛ ዓ.መ.ት.ቁ.ጥር 24 ከ ስ.ብ.መ.ስ.ክ.ረ.ግ. 24 ቀን 2006 ዓ.ም.ገ.ደ. 9

<sup>83</sup> Ayele (n 58)

<sup>84</sup> Ibid

<sup>85</sup> In 2011, this researcher in collaboration with other four persons intended to start a fish breeding business and there arose differences on form of ownership; some say that they should form cooperatives so that they get support from government including income tax exemptions, others insisted for usual investor-owned firms. In order to get the dispute resolved they talked to Officer of Cooperative and Marketing, Hawassa City Administration Trade Sector, Southern Nations, Nationalities and People who alleged that the form of ownership depends fully on the decision of owners regardless of the mission, goal and principles contained in the establishing document.

a price fixed by the Government.<sup>86</sup> The fact that the consumer cooperative society does function contrary to cooperative principle has not bothered the City Administration. Furthermore, the City Administration has been handing over local recreation centers which have been under the control of lowest political administrative organ to groups who organize themselves under the name of “consumer” cooperative society. The Federal Cooperative Commission has made repeated discussion with these government organs so that they accept its advice as to how to deal with cooperatives but still there has not been any significant improvement.<sup>87</sup> This implies that there are no government cooperative policy objectives at the Council of Ministers’ level.

### **C. Relegation of non-agricultural cooperatives**

Even if one believes that there is cooperative policy objective it is only for agricultural cooperatives. The Agricultural Transformation Agency is authorized to develop and has developed a strategy (if we say strategy is equivalent to policy object although this is contestable) only on agricultural cooperatives. “This strategy focuses solely on agricultural cooperatives.”<sup>88</sup> Even rural saving and credit cooperatives are excluded from agricultural cooperative sector development strategies.<sup>89</sup> There is no other organ specifically authorized to develop a strategy for non-agricultural cooperatives such as retail cooperatives, saving and credit cooperatives and workers’ cooperatives. The Federal Cooperative Agency has not been empowered to develop a policy on cooperatives.<sup>90</sup>

Furthermore, even if the Federal Cooperative Agency had been authorized to develop practical guidelines that have to be followed and actions that have to be taken in order to attain the policy objectives,<sup>91</sup> it has not yet developed any such clear guidelines. This is probably because the agency can never mandate other state organs to follow the guidelines<sup>92</sup> or it is difficult to develop the guidelines in the absence of clear policy objectives, or the agency has been preoccupied with agricultural cooperatives.

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<sup>86</sup> See further discussion in Chapter Seven

<sup>87</sup> Ayele (n 58)

<sup>88</sup> Ministry of Agriculture (n 11) 7

<sup>89</sup> Ibid

<sup>90</sup> See Proclamation No.274/2002 (n 52) Art 5

<sup>91</sup> Ibid

<sup>92</sup> See Ministry of Agriculture (n 11) 5. The reluctance of public officers to support cooperatives is identified as one of the seven bottlenecks.

Non-agricultural cooperatives are relegated not only in terms of lack of policy objectives and strategy but also in terms of practical support and promotion. Most cooperatives that are actually receiving the support of Federal Cooperative Agency are agricultural cooperatives. As a result these cooperatives are more successful and take the largest share in cooperative marketing.

## 6.4 Conclusion

To repeat, this thesis argues that cooperatives in Ethiopia have been uncategorized especially from investor owned firms. Each Chapters of the thesis are designed to show why such happened. Chapter One and Chapter Two provides evolution of cooperative ideas and entrepreneurs' rational calculation as justifications. Chapter Three, Four and Five charge the Cooperative Society Proclamation No.147/1998.

This Chapter Six searches if there is any government policy that distinguishes cooperatives from investor owned. However; the finding of the search is that there is no government policy that could enable us to understand cooperative as distinct from investor owned firms.

First of all, in a country that advances developmental state ideology it is implausible to imagine government policy that distinguishes cooperatives from investor owned firms. This is because the major concern of the state is economic development, which could better be achieved through investor owned firms than through true cooperatives. The ultimate objectives of true cooperatives are fairness and equality but not wealth accumulation. Moreover; the authoritarian nature of government in developmental state makes the differing form of economic organization of no practical relevance since the government can direct any form of ownership to whatever purpose it wants.

Secondly, although some policy objectives may be conjectured the fact that the government can use or has been using other alternatives for the same purpose makes such conjecture apparent. On the basis of Growth and Transformation Plan of 2010 and Agricultural Cooperatives Sector Development Strategy 2012-2016 it may be conjectured that the Policy Objective of Government is to use cooperatives as alternative product/input market for small hold peasants/pastoralists. However; the problem of agricultural marketing could be resolved through other alternatives such as commodity exchange markets (a public enterprise that serve as intermediary between the peasant/pastoralists and traders), public enterprises (wholly state owned business enterprises that buy agricultural products from peasants/pastoralists and supplies agricultural inputs) and agricultural products standard and quotes (fixing the standard quality with corresponding prices). Circumstantial evidences may also implicate that the Government has aimed to use cooperatives as a medium of channeling basic goods/services to the Consumers, encouraging saving and

fighting poverty. But since the Competition and Consumer Protection Law of Ethiopia empowers the Government to define basic consumer goods, fix their price and control the distribution, cooperatives are of no better use than investor owned firms. Saving and credit cooperatives would not be the best way for the Government to promote and access savings since it is difficult to direct the use of such money to projects given priority by the Growth and Transformation Plan. Still more, the Ethiopian Government has been using all possible forms of economic organization to fight poverty by classifying them as micro and small enterprises on the basis of their working capital.

Thirdly; the fact that there has also been confusion on what is claimed to be a cooperative policy make such objectives apparent (not serious commitments). The Ethiopian Agricultural Transformation Agency on the one hand asserts the absence of cooperative policy as major bottleneck to cooperative development and on the other hand it states that the policy objective of the agricultural cooperatives is to increase smallholder farmers' productivity and income. There is also no consensus among Government agencies on the policy objectives of cooperatives. Still more; the claimed policy objectives do not include non-agricultural cooperatives.

The next two chapters examine the practice in Ethiopia if in case the practice has some thing to distinguish cooperatives from investor owned firms.



## CHAPTER SEVEN

### THE OBJECTIVES OF COOPERATIVES IN ETHIOPIA

#### 7.0 Introduction

The purpose of this Chapter is to show that in practice the vision of cooperatives in Ethiopia has been profit-maximizing. They are carrying out commercial activities as if they are investor-owned firms. Cooperatives to whom the government has been attempting to assign some public duties have failed to attain such duties. This is demonstrated by showing Ethiopian cooperative's profit-seeking behaviour. Furthermore; the failure of Government's attempt to cooperatives for certain purpose could imply the profit seeking nature of cooperatives.

Mission, goal and vision are all critical components of a cooperative's objectives.<sup>1</sup> The mission of a true cooperative is its collective engagement in economic activities, with the goal of withstanding challenges that are difficult on an individual basis. The vision cooperative is gaining economic and social justice.<sup>2</sup> In contrast the mission of investor-owned firms is gathering money from investors with the goal of maximizing profits. The vision is to make a lucrative profit out of their investments.

The majority of the evidences used in this chapter are collected through interviews. The interview questions were prepared so to ensure that the questions were open-ended and invited interviewees open responses. The persons interviewed were employees of cooperative agencies, employees of cooperative unions, and cooperative management committee members. All interviews were made in person. Interviews were made in Amhara, Oromia, Southern Nations, Nationalities and Peoples and in Addis Ababa. Since the purpose of this research is to investigate the possibility of Cooperatives behaving as investor-owned firms, it was considered necessary only to establish this on a small set of participants and as such no sampling method was required. Due to the limitations placed upon the researcher, the regions are selected mainly due to their accessibility for the researcher. In addition to the interview evidences, documents and official reports were also used as sources of evidence.

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<sup>1</sup>See Chapter Three

<sup>2</sup> Ibid

## 7.1 Cooperative rent-seeking and objectifying profit maximization<sup>3</sup>

The rent seeking profit maximization objective of the cooperatives are inferred from the behaviour of the cooperatives and cooperators using evidence such as the appointment of general managers, profit sharing on the basis of capital contribution, transactions with non-members and investing in profit seeking firms. The principles of autonomy, education and coordination are also factors in the evaluation of whether the cooperative is profit maximizing.

### A. Appointment of general managers

Producer and consumer cooperatives can be considered to focus on the level of collective sales/purchases while worker cooperatives considered focusing on the level of collective production and collective sales. Producers do not normally employ a manager that manages the sale of their products. Similarly consumers do not employ a manager to manage the consumption of goods/services. At most, they can appoint a selling/purchasing agent to manage this for them. Moreover, true cooperatives usually adhere to the principle of collective management.<sup>4</sup> Cooperative transactions are normally relatively simple, since on the one side of a transaction is the member(producer cooperatives purchase from members, consumer cooperatives sell to their members, and worker cooperatives are selling their own product and labour is obtained from members). Therefore, these transactions could easily be managed by committees and agents.

A manager is normally employed by traders since a trader has the purpose of maximizing profits by any means. Under the Commercial Code of Ethiopia 1960, Article 33(1):

*“A manager is a person who has been authorized, expressly or tacitly, to carry out acts of management and to sign in the name of the trader.”<sup>5</sup>*

Ethiopian cooperatives usually appoint general managers.<sup>6</sup> Some cooperatives even go to the extent of entitling the manager to have a share in the annual profit of the cooperative so that

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<sup>3</sup> See also our discussion of indicators of profit-seeking ownership Chapter Five

<sup>4</sup> For example, Ethiopian cooperative law does not recognize the office of the manager. Rather the law provides for management committees and sub-committees. See Cooperative Societies Proclamation No.147/1998<<http://chilot.me/2011/11/22/cooperative-societies-proclamation-no-1471998/>> accessed 30 January 2015, Art 20-27

<sup>5</sup> Commercial Code 1960<<http://www.wipo.int/edocs/lexdocs/laws/en/et/et014en.pdf>> accessed 30 January 2015, Art 33(1)

managers are encouraged to increase the annual profit of the cooperative.<sup>7</sup> The fact that that cooperatives in Ethiopia have been sticking to the office of the General Manager would imply nothing but their desire to make more profit and to act as a trader, using the cooperative's name as a camouflage.<sup>8</sup>

### **B. Profit sharing on the basis of capital contribution**

The other behaviour of Ethiopian cooperatives that reveal their profit maximizing motive is profit sharing on the basis of capital contribution. As stated in the initial discussion on the guiding principles of cooperatives in Ethiopia, one of the areas where Ethiopian cooperatives law expressly merges cooperatives with investor-owned firms is its clear stipulation of distribution of profit on the basis of capital investment; members receive dividend from profit according to their shares and contribution to the capital.<sup>9</sup> In practice also cooperatives strictly adhere to this principle.

### **C. Transactions with non-members**

Transactions with non-members open the door for cooperatives to harbor profit seekers and there is no legal mechanism to rout out such behaviour. Profit distribution on the basis of transactions may not necessarily indicate the existence of non-profit motives.<sup>10</sup> Indeed, it might indicate the opposite. If investment in capital is very minimal then transactions with non-members are

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<sup>6</sup>Daniel Legesse, 'Interview with the General Manager of Addis Ababa Saving and Credit Cooperative Union Ltd' (3 August 2014) Unpublished; I also learnt the same from the interview with Fikre Mekuria, Tewodros Taddele, Mierab Kolfe, 'Interview with Board Chairperson and General Managers of Consumers' Cooperative Union Ltd' (5 August 2014) Unpublished; Gadissa Eda'a and Ayele Bedane, Girma Regassa, 'Interview with the Finance Head, Certificate Officer and Legal Services Head of Oromia Coffee Farmers' Cooperative Union' (8 March 2013) Unpublished. The by-laws (as of January 2008) of Oromia Coffee Farmers' Cooperative Union Ltd Art 24(4) and the by-laws (as of March 2008) of Addis Ababa City Administration, Arada Sub-City, and Kebele 01/02 Consumers' Cooperative Ltd Art 18(6) establish the office of the General Manager.

<sup>7</sup> For example Oromia Coffee Farmers' Cooperative Union Ltd provides such mechanism in its bylaws. See Art 38(1) of the by-laws(January 2008) of the Union

<sup>8</sup> There are indications that show tendencies of seeing cooperatives as an alternative way of involving in economic activities for profit –maximization motives. For example, the Cooperative Academic Departments in Ethiopian Universities in the past have been usually clustered under the College of Agriculture but recently the tendency is clustering them under College of Business and Economics. Similarly in the past(after 1991) cooperative agencies/sectors have been accountable to the Ministry/Bureau of Agriculture but that trend have seemed to change and these agencies are either made directly accountable to the highest executive or even to the Bureau of Trade and Industry like in the case of Addis Ababa City Administration. Some cooperative experts of the government also seem to believe that cooperatives are alternatives to IOFs to make business for profit. I learnt this for example from the interviews with Tesfaye Wami, 'Interview with the Legal Advisor and Promoter, Inspection, Audit and Legal Service Work-Process Main Unit' (4 August 2014) Unpublished; Mulugeta Mengistu, 'Head, Promotion and Development Work-Process Main Unit' (3 August 2014) Unpublished

<sup>9</sup>See Chapter Four

<sup>10</sup> See Chapter Two

disproportionally significant. For example, in Addis Ababa it is enough to contribute 100 birr (about £3) as a share capital to join consumer cooperatives.<sup>11</sup> The total share of cooperative transactions with its members', especially in consumer cooperatives,<sup>12</sup> may be very small and nominal compared to its total transaction value. In this case, the producer cooperative purchases large quantities from non-members and resells these goods which are clear evidence of transacting for profit. Similarly, if consumer cooperatives purchase goods and resell large quantities of the goods to non-members, leaving nominal quantities for its members, it is again transacting for profit. If a worker cooperative employs a large numbers of non-members<sup>13</sup> and also sells goods/services which are not produced by its members, it has a clear motive of profit maximization. Under the guise of creating an alternative product/input market or creating job opportunity or helping the state to control inflation, cooperatives in Ethiopia make unlimited purchases from non-members goods or labour/sale to non-members.<sup>14</sup> Some cooperatives may keep a separate account for net profits obtained from purchase/sale to non-members,<sup>15</sup> but such would only be possible if the members are fully committed to non-profit activities since they could decide to distribute it at any time they want. The legal requirement that thirty percent should be kept in a reserve fund exacerbates the possibility of profit seekers hiding under the cooperative label.<sup>16</sup>

The government has already understood this rent seeking profit motive of cooperatives and has taken different measures to reduce it. For example, the Government of Addis Ababa City Administration encourages members to use their dividends to buy additional shares so that the annual surplus could raise the capital of the cooperatives instead of going to the pocket of the members.<sup>17</sup> The government has also decided that cooperatives should deposit the legal reserve fund in independent government account so that such fund would be out of their reach.<sup>18</sup> When

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<sup>11</sup>See the by-laws (as of March 2008) of Addis Ababa City Administration, Arada Sub-City, and Kebele 01/02 Consumers' Cooperative Ltd Art 10

<sup>12</sup>Consumers' consumption is normally small and inelastic unless every consumer in the locality of the cooperative becomes members.

<sup>13</sup> According to Marxist theory profit is created by extracting unpaid labour from workers. See Roger Backhouse, *The Penguin History of Economics* (Penguin UK, 2002) 159

<sup>14</sup> All interviewees in this research confirmed that cooperatives are encouraged to purchase from/sell to non-members.

<sup>15</sup> See the by-laws (as of January 2008) of Oromia Coffee Farmers' Cooperative Union Ltd Art 38(5).

<sup>16</sup>See our discussion of Collective Ownership Rights in Chapter Five.

<sup>17</sup> Interview with Mengistu(n8)

<sup>18</sup> Ibid

cooperatives are dissolved they are expected to return to the Government the land that was freely assigned to them; the land given to cooperatives is registered by the name of Addis Ababa City Administration Trade and Industry Bureau.<sup>19</sup> The Government has also gone to the extent of limiting the constitutional right of freedom of association stating that anyone who wants to form a consumer cooperative is advised to join the already existing consumer cooperative in their residence.<sup>20</sup> The worker cooperatives in Addis Ababa have been ordered to be converted into investor-owned firms since they have been found to be pursuing a rent seeking profit maximization motive which stands in contradiction to the principles of true cooperatives.<sup>21</sup> Since 2008, the Addis Ababa City Administration has refused to register further Workers Cooperatives.<sup>22</sup>

However, all these measures are illegal since they violate the principle of autonomy, property rights or freedom of association. Advising cooperatives to raise their capital by using annual surplus would amount to interference into autonomy of cooperatives which is expressly recognized by Ethiopian Cooperatives Law. Since the cooperatives have a rent seeking profit motive they may be easily influenced by the government advice into believing that failure to hear the Government's advice would deny them special privileges such as access to land and loans without collateral. In fact according to an interview with Mekuria, Legesse, Eda'a and Bedane cooperative does not exist in Ethiopia and Mengistu believes that the cooperatives are partly autonomous whereas Melese and Wami insist that cooperative autonomy is fully respected.<sup>23</sup> Moreover, the measures do not necessarily restrict the profit motive but may even produce negative effects. The cooperatives would be dissolved and then the capital distributed after it has sufficiently accumulated on the profit-maximizing basis.<sup>24</sup> Some of such measures may also reduce the willingness of the public to join cooperatives since the public would be unable to see the actual benefits of Cooperatives.<sup>25</sup> Transferring the legal reserve fund of cooperatives into a

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<sup>19</sup> Ibid

<sup>20</sup> Ibid

<sup>21</sup> Interview with Birke Melaku, 'Interview with Cooperative Promotion and Development Coordinator' (4 Aug 2014) Unpublished and Abinet Melese, 'Senior Cooperative Promoter, Cooperative Promotion and Development Work-Process Main Unit' (4 August 2014) Unpublished

<sup>22</sup> Ibid

<sup>23</sup> Mekuria (n 6); Legesse (n 6); Eda'a (n 6); Bedane (n 6); Mengistu (n 8). Melese (n 8); and Wami (n 8) insist that cooperative autonomy is fully respected.

<sup>24</sup> Mengistu (n 8) agrees with such possibility although he claimed that cooperatives could not be dissolved without the knowledge of the government.

<sup>25</sup> Melese (n 8)

Government account and denying cooperatives access to this fund before and after liquidation is contrary to the existing Ethiopian cooperatives law and amounts to an illegal expropriation.<sup>26</sup> There is no legal basis for the government to hold the lease of the title deed of land and transfer possession to Cooperatives either in the Urban Land Lease Proclamation No. 721/2011 or in the Cooperative Society Proclamation No.147/1998. Moreover, Addis Ababa City Administration Regulation No. 46/2012 expressly declares the transfer of ownership of property belonging to public shops and other income generating institutions to consumer cooperative societies as an initial capital.<sup>27</sup> The land holding of primary consumer cooperatives in Addis Ababa are those holdings transferred to them according to this regulation.<sup>28</sup> It is also difficult to separate rights to the land from rights to the building constructed on it. Finally, it is a constitutional right of individuals to form Cooperatives as far as they fulfill the requirements stated under Art 9(2) of the Cooperative Society Proclamation No.147/1998.<sup>29</sup>

Generally transaction with non-members opens wider room for Cooperatives to harbor profit seekers and the current attempt of the government to block these profit seekers has no legal basis.

#### **D. Investing in profit seeking firms**

Investing in investor-owned firms is also an indicator of profit seeking motive of cooperatives. Ethiopian Cooperatives have been investing specifically in banking sector. The most prominent example has been the investment in the Oromia Cooperative Bank Share Company. According to an interview with Gadissa Eda'a (Finance Head), Ato Ayele Bedane (Certificate Officer) and Girma Regassa (Legal Service Head) , Oromia Coffee Farmers' Cooperative Union, the major shareholders of this company are Coffee Farmers Cooperatives in the State of Oromia and Oromia Coffee Farmers' Cooperative Union Ltd.<sup>30</sup>. Michael Ayele,<sup>31</sup> Legal expert in Federal

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<sup>26</sup> See Cooperative Society Proclamation No.147/1998 Art(4) and Constitution of the Federal Democratic Republic of Ethiopia 1994 <[http://www.wipo.int/wipolex/en/text.jsp?file\\_id=193667](http://www.wipo.int/wipolex/en/text.jsp?file_id=193667)> accessed 30 January 2015, Art 40(1), 40(2) and 40(8); See our discussion on the purpose of Legal Reserve Fund (n 17)

<sup>27</sup> See A Regulation to Provide for the Transfer of Public Shops and Other Income Generating Institutions to Consumer Cooperative Societies set up in Wereda Level of the Addis Ababa City Government Regulation No.46/2012 Art 4

<sup>28</sup>Melaku (n 21)

<sup>29</sup> Constitution of FDRE (n 26) Art 31

<sup>30</sup>Eda'a (n 6); Bedane (n 6); Regassa (n 6).

<sup>31</sup>Michael Ayele, "Interview with a senior Legal Expert of Federal Cooperative Agency", (12 April 2014) unpublished

Cooperative Agency, also mentioned that Oromia International Bank Share Company is also another investor-owned firm in which the cooperatives have invested their money. The Addis Ababa City Government also helped the cooperatives in the city to establish Addis International Bank Share Company by proposing the idea and making feasibility study with a cost of more than two hundred thousand birr (about £6000).<sup>32</sup> More than 67% of the total capital of this share company is owned by consumer cooperatives, and saving and credit cooperatives in Addis Ababa.<sup>33</sup> These cooperatives are also establishing the Addis Insurance share company.<sup>34</sup>

The cooperators (organizers of cooperatives) and the Addis Ababa City Government are arguing that the cooperatives are establishing banks and insurance firms in the form of a public company not because they are profit seeking but rather because the existing financial regulation law does not allow the formation of a cooperative bank and insurance firm.<sup>35</sup> They assert that cooperatives are unable to access loans from commercial banks since these banks require collateral.<sup>36</sup> They further argue that although the cooperatives have repeatedly appealed to the government to allow the establishment of cooperative banks and insurance firms within the ambit of cooperative law, the government has not shown any willingness to allow such actions.<sup>37</sup> Many of them believe this is because the Government does not want to lose control of the large amount of funds cooperatives have deposited in the state owned Ethiopian Commercial Bank.<sup>38</sup>

However, there is also no sufficient legal reason to establish a cooperative bank from which to access to funding. Producer cooperatives could establish saving and credit scheme to extend loans to its members.<sup>39</sup> Saving and credit cooperatives are legitimate. Members of consumer and worker cooperatives do not normally need loans. If the consumer/worker cooperatives themselves need a loan they can borrow from saving & credit cooperatives or even from producer cooperatives.<sup>40</sup> Cooperatives are expected to be self-help, economic organization and thus they should not need to use the funds deposited in commercial banks; as they should collect the

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<sup>32</sup> Mengistu (n 8)

<sup>33</sup> Ibid

<sup>34</sup> Ibid

<sup>35</sup> Ibid; Legesse (n 6); Mekuria (n 6)

<sup>36</sup> Ibid

<sup>37</sup> Ibid

<sup>38</sup> Ibid

<sup>39</sup> Proclamation No.147/1998 (n 4) Art 35; See also the by-laws of Oromia Coffee Farmer Cooperative Union Ltd (January 2008) Art 24-30

<sup>40</sup> Proclamation No.147/199 (n 4) Art 35

necessary funds they need from members of the cooperative. There is no law that imposes maximum loan selling. The existing financial regulation law does not attempt to regulate the funds that circulate in the economy from cooperatives, and as such should be considered to be a special privilege of cooperatives. So there is no legitimate reason for cooperatives to rush to establish bank and insurance firms in the form of a public company except to satisfy their profit seeking desires;<sup>41</sup> financial regulation law acts as nothing more than a convenient disguise for this behaviour.

#### **E. Compromising principles of open-membership, autonomy, education and coordination**

The Ethiopian cooperatives do not live up to fundamental principles of true cooperatives such as open membership, autonomy, education and coordination for self-interested reasons. Many cooperatives are unwilling to admit new member for fear that if new members are added, the benefit they have got from the government would have to be shared out equally.<sup>42</sup> Many Ethiopian cooperatives are not sufficiently resisting government interference since they receive subsidies granted on their continued service in furthering Government objectives.<sup>43</sup> The cooperative education and promotion (teaching of the cooperative ideology to the public and to the youth) is carried out by the government rather than undertaken by the Cooperatives themselves.<sup>44</sup> There is very little cooperation between cooperatives as each cooperative prefers to stick to its own interests and locality.<sup>45</sup>

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<sup>41</sup> There is no clear reason why the Ethiopian saving and credit cooperatives become eager to use the word bank in their name. If they want to be big enough they have to work hard to increase the number of their members and small cooperatives should be amalgamated. There is no legal restriction on the maximum number of members or capital. Although there seems to be territorial restriction such restriction would not be an obstacle to raise large saving fund because the law does not clearly define territorial limit (see Proclamation No.147/1998 (n 4) Art 6(2)).

<sup>42</sup> Melaku (n 21); Melese (n 8)

<sup>43</sup> Mekuria (n 34)

<sup>44</sup> Melaku (n 41); Melese(n 8) and Daniel Legesse, 'Interview with Addis Ababa Saving and Credit Cooperative Union Ltd, General Manager (4 August 2014) Unpublished

<sup>45</sup> Mekuria(n 34) and Legesse (n 43)



## 7.2 Evidence that the Government is using cooperatives as a policy instrument<sup>46</sup>

As was the culture in communist countries and in Africa, the Ethiopian Government since the 1980s has continued to use cooperatives as a means to implement its own economic and political objectives. However, the cooperatives seem to have been resistant to this in some respects and they have proved to be unsuitable vehicles for promote Government policy. In this sub-topic we review major policy areas where the Government has tried to use cooperatives in this way. The main sources of information for this section are policy documents and interviews.

### A. Cooperatives as a means to implement Government policies

The Ethiopian government has an objective of using cooperatives an instrument to attain its policy objectives.<sup>47</sup> The major areas where cooperatives have been intended to be used are in inflation control, agricultural marketing, to mobilize rural saving programs and in political indoctrination.. Let us see these areas in some details.

#### *Consumer cooperatives as a means of inflation control*

The Government considers high inflationary pressure a serious challenge to macroeconomic stability.<sup>48</sup> Thus, inflation control is one of the core objectives of the growth and transformation plan of the Government.<sup>49</sup> The Government believes that the major causes of price inflation in Ethiopia are inefficient monopolistic domestic market, international price inflation and monetary policies of the Government.<sup>50</sup> Reducing the transaction chain by avoiding ‘middlemen’, subsidizing basic goods and price fixing have been taken as solutions to these problems.<sup>51</sup> The government has preferred consumer cooperatives as means to implement the solutions since the

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<sup>46</sup>Under this topic, we show that the Government intends to use cooperatives as an instrument to attain its policy objectives. See our discussion of Ethiopian Cooperative Policy where we showed that the Ethiopian Government does not have policy that makes the existence of cooperatives the only or best alternative.

<sup>47</sup> See የኢ.ፋ.ዲ.ደ. ህ.ዲ.ሪ. ን ስሜት ዲ.ዲ.ሞክሮ ራ.ሲ.ዶ ዲሙኒ ግስታችን የስድገት መርህ ህግ 2004 ዓ/ም 122 ከ 5 ገጽ 146-148; Ministry of Finance and Economic Development, ‘Growth and Transformation Plan of 2010’ (2010) <<http://www.mofed.gov.et/English/Resources/Documents/GTP%20English2.pdf>> accessed 30 January 2015

<sup>48</sup> See የኢ.ፋ.ዲ.ደ. ህ.ዲ.ሪ. ን ስሜት ዲ.ዲ.ሞክሮ ራ.ሲ.ዶ ዲሙኒ ግስታችን የስድገት መርህ ህግ 2004 ዓ/ም 122 ከ 5 ገጽ 126

<sup>49</sup> Ibid

<sup>50</sup> Ibid 126-127

<sup>51</sup> Ibid

government is suspicious of the private sector.<sup>52</sup> According to a document prepared by the ruling party in 2011 the government in power believes that private sector firms are its political rivals and usually wasteful rent seekers or remnants of the past regime.<sup>53</sup>

According to an interview with Mengistu, Mekuria, Legesse, and Tesfaye since 2008, the Government has been working immensely hard to increase the number of consumer cooperatives so that it would be easier to control the proper implementation of price fixing and to distribute government subsidized goods to the public, while also trying to avoid the unnecessary benefit that would go to the intermediary.<sup>54</sup> According to the Addis Ababa City Government Regulation No.46/2012 to encourage consumer cooperatives, the Addis Ababa City government went to the extent of dissolving the existing public shops and other income generating institutions and transferring their immense wealth to the consumer cooperatives established at the Wereda level.<sup>55</sup> According to an interview with Mengistu the wealth transferred to consumers cooperatives worth more 159 million birr (about five million pound).<sup>56</sup> Mengistu further stated that 70 million birr (about 2.5 million pound) loan without collateral has been given to the cooperatives by the government.<sup>57</sup>

## Producers' cooperatives as a means to agricultural marketing<sup>58</sup>

Effective and integrated input and product agricultural marketing in rural Ethiopia has been taken by the Government as a necessary condition for agricultural productivity.<sup>59</sup> Wary of the private sector the government<sup>60</sup> has preferred agricultural producer cooperatives to create

<sup>52</sup>Tesfaye Matewos Kalo, 'Interview with Cooperative Societies 'Organization and Registration Officer' (25 June 2014) Unpublished

<sup>53</sup> The existing government claims that its political basis is the peasantry. The fact that it is a leftist government would also make it suspicious of the private sector. The Government have already declared neo-liberalism as an ideology that promote rent-seeking and private sectors as major beneficiaries of such ideology. Hence, to gain political basis in urban areas and to do away with neoliberalism and beneficiaries of this ideology the Government has been working to recreate and incubate developmental private sector from micro and small scale enterprises. See (n 47) in general and 154-160 in particular.

<sup>54</sup>Mengistu(n 8); Mekuria(n 34); Legesse(n 6); Tesfaye Kalo (n 51)

<sup>55</sup> Addis Ababa City Government Regulation No.46/2012; According to an interview with Mengistu (n 8) the wealth transferred to consumers cooperatives worth more 159 million birr (about five million pound).

<sup>56</sup> Mengistu (n 8)<sup>57</sup>Mengistu(n 8)

<sup>58</sup> See our discussion on this issue under cooperative policy in Ethiopia in Chapter Six

<sup>59</sup> See የ ሲ ዮ ቶ ያ ህ ዳ ሴ ና የ ስ ማ ታ ዊ ዲ ሞ ክ ራ ሲ ያ ዊ መን ግ ስ ታ ቾን የ ስ ድ ገ ት መርህ ህ ሞቾ መህጋቢት 2004 ዓ / ም 146-147

<sup>60</sup> In fact the agricultural input has been provided by companies owned by the ruling party.

effective and integrated agricultural marketing.<sup>61</sup> Especially, in the agricultural product market, agricultural product cooperatives have been expected to connect the small hold farmers to the Ethiopian Commodity Exchange.<sup>62</sup>

To create the expected type of cooperatives the Government has been working hard. In 2012, the Agricultural Transformation Agency prepared the Agricultural Cooperative Sector Development Strategy 2012-2016.<sup>63</sup> The Federal Cooperative Agency in collaboration with regional agencies has been promoting and assisting the formation and strengthening of agricultural cooperatives.<sup>64</sup> To further strengthen the process an Agricultural Cooperative College has been considered.<sup>65</sup> The government has also planned to introduce certification and rebranding of agricultural cooperatives.<sup>66</sup> The certification and rebranding has been expected to provide “farmers and other services providers [with] a strong mechanism to differentiate well performing co-operatives from others who are co-operatives in name only”.<sup>67</sup>

### **Saving and credit cooperatives as means of mobilizing rural saving**

The government has planned to increase national saving from 10% of the GDP to 15% of the GDP.<sup>68</sup> It is also believed that one of the major reasons that hindered saving is the absence of efficient saving institutions in the rural areas.<sup>69</sup> Rural saving and credit cooperatives have been taken by the government as an alternative solution.<sup>70</sup> Accordingly, rural saving and credit cooperatives have been promoted,<sup>71</sup> although the Growth and Transformation Plan of 2010 and the Agricultural Cooperative Sector Development Strategy 2012-2016 did not mention of them.<sup>72</sup>

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<sup>61</sup> See የ ኢ.ዮ.ድ.ያ.ህ.ዳ.ሴ.ና.የ.ሰ.ሣ.ታ.ወ.ዲ.ሞ.ክ.ፌ.ሲ.ያ.ወ.መ.ነ.ግ.ስ.ታ.ች.ን.የ.ስ.ድ.ገ.ት.መ.ሮ.ህ.ሣ.ታ.ሚ.ቢ.ት 2004 ዓ / ም pp.146-147

<sup>62</sup> Ibid

<sup>63</sup> See Chapter Six, Section 6.2

<sup>64</sup> Ayalew (n 31)

<sup>65</sup> Ibid

<sup>66</sup> Ibid.

<sup>67</sup> Ministry of Agriculture, ‘Agricultural Cooperatives Sector Development Strategy 2012-2016’ (2012) <[http://api.ning.com/files/464c0NtXZtDs3-DGp0RziNVQaTPSSRO\\*4np2q7x0UaI4G1PRQeVzXmIf6zNOXGAR8-xiqLonmnmlpW-RwUedIEmMdP5qED0b/AgriculturalCooperativeSectorDevelopmentStrategy201220163.pdf](http://api.ning.com/files/464c0NtXZtDs3-DGp0RziNVQaTPSSRO*4np2q7x0UaI4G1PRQeVzXmIf6zNOXGAR8-xiqLonmnmlpW-RwUedIEmMdP5qED0b/AgriculturalCooperativeSectorDevelopmentStrategy201220163.pdf)> accessed 30 January 2015, 33

<sup>68</sup> See የ ኢ.ዮ.ድ.ያ.ህ.ዳ.ሴ.ና.የ.ሰ.ሣ.ታ.ወ.ዲ.ሞ.ክ.ፌ.ሲ.ያ.ወ.መ.ነ.ግ.ስ.ታ.ች.ን.የ.ስ.ድ.ገ.ት.መ.ሮ.ህ.ሣ.ታ.ሚ.ቢ.ት 2004 ዓ / ም pp.118-119

<sup>69</sup> Rural micro financial institutions that have been functioning are claimed to be inefficient. See Ibid 120 and 122

<sup>70</sup> Ibid 122

<sup>71</sup> Michael Ayalew, ‘Interview with Senior Legal Expert, Federal Cooperative Agency’ (24 February 2014) Unpublished

<sup>72</sup> See our discussion of conjecturable policy objective of saving and credit alternative in Chapter Four.

### **Cooperatives as a form of political indoctrination**

The ruling party has an ambition of creating the long lasting hegemony of developmental state status.<sup>73</sup> It aims to create a political landscape where only political parties that accept the development state ideology are able to win democratic elections and where liberal and other ideologies will be marginalized in Ethiopian politics.<sup>74</sup> It believes that such a long lasting hegemony is possible, if and only if, the idea becomes the prevailing public attitude and embeds itself in popular culture.<sup>75</sup> It aims to meet the target through success in economic development and good governance.<sup>76</sup> This approach is not widely considered to be sufficient to be persuasive and so the government also relies on ideological persuasion.<sup>77</sup> Indoctrination forms an indispensable mechanism of the ruling party in creating long lasting hegemony of the developmental state ideology in Ethiopia.

The party document published in March 2012 indicates that, in addition to state owned and party owned Medias, the Government has planned to use academic institutions, associations (including the investor-owned firms' association) and religious associations as a medium to further the Government's policy objectives.<sup>78</sup> Although cooperatives are not expressly mentioned in the document the fact that the party is ready to use such a range of associations suggests the policies of the previous Marxist Government in using cooperatives as a means of indoctrination may once again be resurfacing. Interviews made with Ato Mulugeta Mengistu, Main Work-Process Unit Head, and Ato Tesfaye Matewos, Officer, Cooperative Society Promotion and Registration Sector<sup>79</sup> are congruent with this conclusion. For example, according to Ato Mengistu one of the objectives of cooperatives is "to create healthy relationship between the public and the government."<sup>80</sup> This assertion may only be limited to the indirect consequence of distribution of quality goods at fair price but it could also mean the creation of ideological consensus between the Government and the public, by indoctrinating the public to the developmental state ideology

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<sup>73</sup> See የኢ.ዮ.ዲ.ደ.ህ.ዳ.ሴ.ና.የ.ሰ.ሚ.ታ.ዊ.ዲ.ሞ.ክ.ራ.ሲ.ዶ. ዊ.መ.ን. ግ.ስ.ታ.ች.ን. የ.ስ.ድ.ገ.ት.መ.ፎ.ህ.ሀ.ዎ.ች.መ.ጋ.ቢ.ት 2004 ፃ/40

<sup>74</sup> Ibid 86-88; Although the ruling party is currently a vanguard party, it does not seem to be happy with this status quo since it is difficult to appear democratic to the Western donors. As a result, it aims to create strong opposition parties within the ambit of developmental state ideology.

<sup>75</sup> Ibid 40

<sup>76</sup> Ibid 198

<sup>77</sup> Ibid 198

<sup>78</sup> Ibid 78-81 and 202

<sup>79</sup> Mengistu(n 8); Tesfaye Matewos (n 52)

<sup>80</sup> Mengistu(n 8);

through cooperative., Similarly, according to Matewos, one of the objectives of cooperatives is “to indoctrinate the idea of mutual development among the public.”<sup>81</sup> Although the merits of such a scheme would be to have a public which subscribe to the idea of mutual benefit it nonetheless remains a Government propaganda campaign through which it pursues developmental state ideology. Thus it is clear that the Government intends to use cooperatives to promote government policy.

### **7.3 Where the Government has succeeded in meeting its objectives?**

However, in a policy document prepared in March 2012 by the ruling party it has been expressly and vigorously admitted that agricultural marketing and rural saving and credit cooperatives have not been able to serve the government to attain its policy objectives.<sup>82</sup> Furthermore, although the document further indicated that unless research that would fundamentally solve the problem is made by taking Taiwan cooperatives as the best practice, the agricultural sector development would be in jeopardy;<sup>83</sup> since then there has been only a plan to introduce certification and rebranding.<sup>84</sup>

The Government’s attempt to increase membership of cooperatives has also failed. This is evident from the fact that the Ethiopian Central Statistics Agency, an independent agency that makes statistical data collection has no any data relating to cooperatives. According to an interview with Zelalem, the Business Statistics Directorate Director, and Ethiopian Central Statistics Agency, the agency collects data if it is convinced that the data could have some impact on the analysis of Ethiopian Economy.<sup>85</sup> He further stated that the Central Statistics Agency has no any record or data concerning cooperatives.<sup>86</sup> According to Mengistu, Wami, Melaku and Melese in Addis Ababa, the City Government has planned to increase the number of members to fifty percent of the total population of Addis Ababa.<sup>87</sup> But the increase of number of

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<sup>81</sup> Matewos (n 52)

<sup>82</sup> See የኢ.የ.ድ.ደ.ህ.ዳ.ህ.የ.ሰ.መ.ታ.ዲ.ዲ.ሞክ.ራ.ሲ.ደ.ዊ.መ.ን.ገ.ስ.ታ.ቸ.ን.የ.ስ.ድ.ገ.ት.መ.ር.ህ.የ.ቸ.መ.ጋ.ቢ.ት 2004 ዓ/ም p. 122, 146, 148

<sup>83</sup> Ibid 146-148

<sup>84</sup> Ayalew (n 69)

<sup>85</sup> Zelalem Hailegiorgis ‘Interview with the Business Statistics Directorate Director, Ethiopian Central Statistics Agency’ (31 July 2014) Unpublished

<sup>86</sup> Ibid

<sup>87</sup> Mengistu (n 8); Wami(n 8); Melaku(n 41); Melese(n 8)

members of the consumer cooperatives has been stagnant. For example, in Arada Sub-City the annual increase of cooperative membership has been about 4.5%.<sup>88</sup>

Melaku and Melese (Cooperative Team Leaders in Arada Sub-City, Addis Ababa) also testifies that the public has been unenthusiastic about joining cooperatives and cooperative members have been unwilling to appear at the annual general meeting.<sup>89</sup> The reluctance of members shows the lack of enthusiasm to push the cooperative mission. Melaku and Melese further state that such lack enthusiasm has also blocked the possibility of new members joining the cooperatives because the admission of new members has to be approved by the general meeting.<sup>90</sup> Moreover, according to these interviewees this reluctance has also negatively influenced the public against joining cooperatives since the general meeting is required to decide on the distribution of surplus which could have served as an incentive to attract new members.<sup>91</sup> This would stop votes on membership or surplus distribution). The interview with Wami (the Legal Advisor and Cooperative Promoter, Addis Ababa City Administration) and Matewos (Cooperative Promotion Officer, Hawassa City administration) also show that even the members of the management committee have been unwilling to hold regular meetings and to attend the training organized by the government to promote cooperatives.<sup>92</sup> According to Melaku and Melese although the Addis Ababa City Government has gone to the extent of paying an allowance and telephone fees to the committee, they are yet to demonstrate the desired enthusiasm for the role.<sup>93</sup>

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<sup>88</sup> In an interview with Melaku (n 41) and Melese,(n 8), I got a piece of paper that contained an attempt to show membership increase of consumer cooperatives in the sub-city from 2012/13 to 2013/14. According to the document, in 2012/13 the total member was 24,814 and such number increased to 25,918 in 2013/14. It was not possible to get similar information from other sub cities because they never keep statistical data (Interview with Mengistu (n 8)). Even the data obtain from Arada sub city may be unreliable since it is a common sense that there is always a tendency in Ethiopia to exaggerate statistical data to prove success of the ruling party. For example the data I received in the city level for number of members of consumer cooperatives in Arada Sub-city for the year 2013/2014 is 31655 which contradicts with what I received in the sub-city level (Mengistu (n 8)). So this researcher believes that the number of members of the consumer cooperatives in Arada sub-city is probably much less than what the sub-city claimed. This would be better in the main text- slightly rewritten

<sup>89</sup> Melaku (n 41) and Melese,(n 8). Very few employees of Cooperative Society Promotion and Development Sector and offices of Addis Ababa City Government are members of consumer cooperatives. Employees of the government who gave me interview are not members of cooperatives and they do not see any benefit of membership. Ibid See also interview with Wami(n 8) and interview with Mekdes Yonas, 'Interview with the Record Officer of the Cooperative Society in the Promotion and Development Sector of the Trade & Industry Bureau of the Addis Ababa City Government' (30 July 2014) Unpublished

<sup>90</sup> Ibid

<sup>91</sup> Ibid

<sup>92</sup> Ibid; Wami(n 8); Kalo(n 51)

<sup>93</sup> Melaku(n 41); Melese (n 8)

In short, the cooperative movement under the leadership of the government has failed to attain the mission it has aimed for. The Record Officer of Cooperative Society Promotion & Development Sector, Trade & Industry Bureau, and Addis Ababa City Government, described the failure of Consumer Cooperatives in Addis Ababa as nothing more than ‘a forum of disputes and misunderstandings.’<sup>94</sup>

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<sup>94</sup>Yonas(n 90)

## 7.4 Conclusion

This Chapter Seven has attempted to see if the practical operation of cooperatives has remedied the defects of the Cooperative Law and the Cooperative Policy in distinguishing cooperatives from investor owned firms. However; the practical operation of cooperatives shows that the legal and policy defects have been given real life since in practice the vision of cooperatives in Ethiopian has been profit-maximizing. In Chapter Five we have seen that the ownership rights in cooperatives which include the right to manage the firm are as wide as that of investor owned firm.

This Chapter shows that such wider rights exist not only in theory but also in real operation of cooperative. The owners of a cooperative firm freely determine how to manage the firm and appoint a professional manager implying their profit-seeking motives. User cooperatives could be managed by the committee elected from members. Ethiopian Cooperatives also distribute profit on the basis of capital contribution. They also trade with non-members reinvest their annual surplus in the investor owned firms and unwilling to admit new member. Although the government has recognized such profit-seeking behaviours of cooperatives and has been taking measures that may neutralize such motives, the measures do not have strong legal ground. Still more, although there are evidences that the government has also attempted to assign certain objectives such as channeling basic goods to consumers, serving as alternative agricultural input and out put market for small hold peasant/ pastoralists, mobilizing rural saving and serving as forum to indoctrinate developmentalism to the public, which would detract cooperatives from their profit-seeking motive; such attempts of the government have not proved successful.

This chapter has examined the practice from the vantage point of cooperative objectives. The next chapter examines the practice from the vantage point of regulation.



## **CHAPTER EIGHT**

### **REGULATION OF COOPERATIVES IN ETHIOPIA**

#### **8.0 Introduction**

Not-for-profit cooperatives are either autonomous, philanthropist dependent or state dependent.<sup>1</sup> The defining characteristic of true cooperatives is their non-profit seeking orientation. The behaviors of cooperatives must correspond with their motive and there should be mechanisms in place that encourage cooperatives to behave accordingly. Regulation is an indispensable mechanism in achieving this end and in realizing the objectives behind cooperatives.

Regulation may be either self-regulation or state-centered regulation and this may be dependent on what the objectives of cooperatives are. Both self-regulation and state-centered regulation presuppose the existence of a strong motive behind the missions and goals of cooperatives. Self-regulation would be effective only when members of cooperatives have a convincing reason to comply. State regulation would be successful when the State is incentivized to ensure compliance because it depends on the success of cooperative for various reasons (noted in chapter six and seven). Cooperation among cooperatives is important for self-regulation and legal mechanisms are important for state-centered regulation.

However, in Ethiopian cooperatives there is neither self-regulation nor state-centered regulation. Members of cooperatives in Ethiopia do not have sufficient reason to cooperate and resultantly there is no cooperation between cooperatives. The excessive interventionist ideology and behaviour of the State has denied members of cooperatives a reason to cooperate. The Ethiopian government lacks a reason to stick to its cooperative strategy. Finally, the lack of legal authority behind the cooperative principles, indiscriminate granting of special privileges, limited power of cooperative agencies and the pretext of autonomy of cooperatives have further limited the State's ability to regulate cooperatives.

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<sup>1</sup>See our discussion on Chapter One

This chapter is set out as two sub-topics. One, an analysis of cooperative regulation, and two, an analysis of cooperative regulation specifically in Ethiopia. The first sub-topic reviews the purpose of regulation, types of regulation and conditions necessary for regulation. The second subtopic seeks to demonstrate that regulation does not really exist in the Ethiopian Cooperative Movement.

The first sub-topic is argued using academic writings. The evidence used in the second sub-topic are interviews material with employees of cooperative agencies, employees of cooperative unions, and cooperatives' management committee members. The interview questions were predesigned open-ended questions. The purpose of these interviews was to assess if there is either self-regulation or state regulation of cooperatives in Ethiopia. Documents and official reports were also used as sources of evidence.

## **8.1 Regulation of cooperatives in general**

Regulation is a mechanism to ensure that cooperatives are moving towards their ultimate objectives. This can be achieved through the mechanism of self-regulation or state-centered regulation. Motives, coordination and legal frameworks are important for regulation to exist. Let us see these issues in some details.

### **A. The purpose of regulation**

True cooperatives have social objectives that they aim to attain. Their constitution will set out principles to guide their social objectives. Regulation ensures adherence to these cooperative principles. Any rule if not enforced is of no value. If cooperatives are not made to adhere to cooperative principles, it may be preferable that they should lose their special nature and become investor-owned firms. Furthermore, their failure to adhere to cooperative principles may also negatively affect the chance of true cooperatives to emerge, since it may create negative public impression about cooperatives in general. Thus the purpose of regulation (and penalties for noncompliance) is to keep cooperative distinct from investor-owned firms.

### **B. Types of regulation of cooperatives**

Cooperative principles are enforced either through self-regulation or state-centered regulation. Self-regulation is when the enforcement of cooperative principles are carried out by a personal

commitment of each member to adhere to and respect the cooperative principle, and that commitment is rewarded and encouraged by the cooperative. It also means when the cooperative principles are made a part of the cooperative's operating practice and enforced by the organization itself through self-reward and/or self-punishment. State regulation is when the cooperative principles are made part of the cooperative law and enforced by the government either by means of reward or punishment or both.

These types of regulation are largely dependent on where the sources of the cooperative objectives/visions derive their meaning. If the objective/vision is solely initiated by the cooperatives' members the type of regulation is mainly self-regulation, but if the objective/vision is initiated by Government then it is likely to be a tool or mechanism to attain certain public objectives and would be categorized as state-centered regulation. However, self-regulation would be more effective if the government recognized that cooperatives are not investor-owned firms, charities or societies but self-help economic organizations. Such recognition would help true cooperatives fight back against investor-owned firms masked as cooperatives. Equally, state regulation would also be more effective if complemented by some form of self-regulation.

### **C. Self-regulation**

At least two things have to be fulfilled for self-regulation to be effective. The first part is motivation. Human beings can be viewed as rational beings and hence their behaviors are mostly rationally shaped. Individuals act or abstain from acting if such an act or inaction would produce some positive effect to his satisfaction. Cooperative self-regulation can also benefit from being seen in the light of rational decision making. The second part is cooperation among cooperatives. The fact that there may be multiple cooperatives formed in the same local area necessitates the institutional cooperation among these cooperatives, so that uniform cooperative principles would be developed which would make self-regulation feasible.

As stated earlier, self-regulation is when the enforcement of cooperative principles are carried out by the members of the cooperatives and the cooperatives themselves.<sup>2</sup>Self-regulation takes

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<sup>2</sup>Self-regulation is the feature of a number of professions in western countries. For example, in the U.S. the Government delegates aspects of financial market regulation to self-regulatory organizations (SROs) like the New York Stock Exchange and the National Association of Securities Dealer, securities industry organizations that are owned and operated by their member. Among the SROs' tasks is to design rules governing their members' practices.

place outside the institutions of government and, hence, in the realm of private actors rather than public actors.<sup>3</sup> Most often institutions that impose sanctions on violators have to be established so that individuals are made to behave in accordance of a certain rule.<sup>4</sup> However, such rules may sometimes be enforced without institutions.<sup>5</sup> Cooperative self-regulation may emanate either from the commitment of each individual member or from the cooperatives as an institution. Individual members of cooperatives may make sacrifices<sup>6</sup> to make sure that the cooperatives would attain their ultimate end. Such individual behaviour would gradually become a social norm which imposes social sanctions on rule violators.<sup>7</sup> Cooperatives, as institutions, can punish a member who has been found to have violated the cooperative principles.

Cooperative principles are ordinarily enforced through self-regulation. When we look at the historical development of cooperatives they emerged out of the activities of ideologically committed philanthropists such as Robert Owen, or particular interest groups such as labourers, consumers and small holding farmers. The Kibbutz, Moshav and Moshav Shitufi of the Israeli Community before the formation of the State of Israel were also good examples of self-regulated social organizations<sup>8</sup>. Cooperatives emerged as altruistic or self-help organizations where there

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In addition, SROs are responsible for enforcing their own rules as well as federal securities laws. They conduct disciplinary proceedings and impose sanctions on members for violations. Self-regulation is also a feature of other professions, including accounting, law, and medicine. State accounting boards and the American Institute of Certified Public Accountants (AICPA), voluntary membership organizations for accountants, conduct investigations and impose disciplinary actions on accountants who commit fraud or otherwise violate the code of conduct. In some states, state bar associations handle attorney disciplinary matters. State medical boards handle physician disciplinary matter. Peter DeMarzo, Michael Fishman and Kathleen Hagerty 'Self-Regulation and Government Oversight' (2005) 72(3) *The Review of Economic Studies* 687-706; Self-regulation is also the main attributes of the Japanese industries where trade associations create both rules of trade for a particular industry and sanctions to enforce them. Ulrike Schaede, 'Cooperative Capitalism: Self-Regulation, Trade Associations, and the Antimonopoly Law in Japan' (2002) 28(1) *Journal of Japanese Studies* 203; In Ethiopia there are no self-regulated professions. This may be either because the professions are too infant or the state ideological inclination towards the left or both.

<sup>3</sup>David Baron, 'Morally Motivated Self-Regulation' (2010) 100(4) *The American Economic Review* 1299

<sup>4</sup>Christoph Hauert, Arne Traulsen, Hannelore Brandt, Martin Nowak and Karl Sigmund, 'Via Freedom to Coercion: The Emergence of Costly Punishment' (2007) 316(5833) *Science*, New Series 1905

<sup>5</sup> Ibid

<sup>6</sup>Sacrifices include such as forgoing profit collection on the basis of capital investment or criticizing defectors without mercy, serving in the management of cooperatives for free, taking time to advocate cooperatives' ideology or in short behaving as exemplary cooperator so that others would possibly follow his suit.

<sup>7</sup>Baron (n 3)

<sup>8</sup> "The Kibbutz is a collective settlement, both in production and in consumption, in which members' contributions to production are more or less based on the principle of 'from each according to his abilities' and distribution and consumption follow the rule of 'to each according to his needs.' The Moshav is a smallholders' village with individual production and extensive cooperative organization for marketing, supply, public and educational services, and mutual liability for financial obligations. The Moshav Shitufi maintains collective production and distribution according to the specific needs of each member, with private consumption "The goal of the coops was to provide means of existence for the Jewish in Palestine and their vision was 'laying the foundations of a new Jewish

was no state support available to the poor laborer, consumer, smallholder and new settler. The central tenet of cooperatives is of “promoting conceptions of self-sufficiency.”<sup>9</sup> State involvement in the enforcement of cooperative principles was the exceptional phenomenon of colonial settlement in Africa and statism of the twentieth century.<sup>10</sup>

### *Motivation as a Source of Self-Regulation*

Self-regulation can result from a variety of motivations including self-interest and altruistic moral concerns.<sup>11</sup> Self-regulation of cooperatives initiated philanthropists mainly results from altruistic moral concern.<sup>12</sup> Self-interest was probably the reason for the self-regulation of the British Owenite, Rochdale Pioneers, consumer cooperatives and the American Producer Cooperatives. The Kibbutz, Moshav and Moshav Shitufi of Israel were motivated by the impact of strong Jewish nationalism (Zionism) and a higher sense of justice.<sup>13</sup> As a result they were able to cultivate “altruistic qualities in its members, by educating them to subordinate their private desires for the sake of the community.”<sup>14</sup>

This would lead to the conclusion that the decline of the moral or self-interest concern would lead to the decline of self-regulation. The cooperative movement began to decline in the twentieth century because governments began to involve themselves in economic activities in the form of government production and distribution of goods and services, or price regulation, social welfare, and consumer protection. The emergence and triumphs of communism and socialism and welfare states in the twentieth century has led to the decline of moral or self-interest concerns for true cooperatives.<sup>15</sup> Communism and socialism, social welfarism and even developmental statism are competing ideologies with cooperativism, whereas cooperativism is complementary to classical liberalism. While the communist and socialist ideology holds that political institutions should help the disadvantaged section of the society, cooperativism and

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community in Palestine’ See Yehuda Don, ‘Adaptation of Cooperatives to Economic Changes: The Israeli Experience’ (1967) 49(1) Journal of Farm Economics 119-130 121-122

<sup>9</sup> Ibid 123

<sup>10</sup> See Chapters on history of cooperatives in Africa and Socialist countries.

<sup>11</sup> See Baron (n 3)

<sup>12</sup> Self-interest may play some role at least in shaping the behaviors of members of the cooperatives and the cooperatives themselves.

<sup>13</sup> Don (n 8) 121

<sup>14</sup> Ibid

<sup>15</sup> See our discussion in chapter one section 1.2

liberalism leave the responsibility on individuals to self-help. As such “organizations that represent rival ideologies cause ideological competition, which should increase failure, while organizations that represent shared ideologies cause ideological mutualism, which should decrease failure.”<sup>16</sup> Similarly the Kibbutz, Moshav and Moshav Shitufi of Israel declined after the formation of the State of Israel in 1948 since some of the principal factors which had served as a motivational driving force behind cooperative activity, disappeared.<sup>17</sup>

*“The foundation of the independent state of Israel created an identity of interest between the Jewish community and the authorities. The government established efficient administrative machinery which took the place of the parallel voluntary instruments of the pre-independence community. Care for taxation, defense, education, and social security has passed to the government, which possesses the power of coercion to force its decisions upon individual citizens. Such development has undoubtedly meant the normalization of the political and economic situation. Yet it has narrowed the field for voluntary activities. Thus, one of the most basic motivational forces for cooperative action in the past, namely, the specific economic and social needs served by cooperatives, has come to be regarded by many as passé.”*<sup>18</sup>

In summary, without motivation, self-regulation may be impossible. Cooperatives have generally lost the motivation necessary for self-regulation since the beginning of 20<sup>th</sup> century.<sup>19</sup>

#### *Cooperation as source self-regulation*

Although motivation is necessary for self-regulation, on its own, it is not enough. Since cooperatives are established by taking into account locality issues,<sup>20</sup> effective and successful self-regulation requires an apex cooperative organization that will assist groups and people to come together and coordinate their efforts. Cooperation is the philosophical and ideological foundation of cooperatives. The principle of education would also be better facilitated through community

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<sup>16</sup> Paul Ingram and Tal Simons, ‘State Formation, Ideological Competition, and the Ecology of Israeli Workers’ Cooperatives 1920-1992’ (2000) 45(1) Administrative Science Quarterly 25

<sup>17</sup> Don (n 8) 126

<sup>18</sup> Ibid (emphasis added)

<sup>19</sup> See our discussion supra in Chapter One section 1.2

<sup>20</sup> If the cooperatives have to meet their objectives members should be peoples of the same locality. See our discussion in Chapter Three (n 41)

association of cooperatives than by individual effort of each cooperative. There has been cooperation among British retail cooperatives and the cooperative whole sale has been the result of such cooperation. In the United States the National Cooperative Business Association (NCBA) helps to achieve this principle on national level. The International Cooperative Alliance is also responsible to facilitate principle of cooperation in the international level. In addition to these organizations, there are several home pages intended to coordinate cooperative movement.<sup>21</sup>

#### **D. State regulations**

If the state is willing to regulate cooperatives it could do so either directly by making them accountable to the government or indirectly by considering the cooperatives as a private affair but making special benefit conditional up on fulfillment of certain circumstance.

##### *Direct State Control*

Direct state regulation exists when the state considers the enforcement of cooperative law not only a private matter but also a public matter and will control the violation of cooperative law. The extent of direct control may be as wide as making cooperatives accountable to the government office or as narrow as licensing, supervision and inspection. The extent of a state intervention in cooperative management depends on the extent of the role to which the state wants cooperatives to play in economic, social and political life of the society. Marxists and African governments of pre-1991 had an intention to use cooperatives as an important means to attain communist indoctrination and economic growth. As a result, such systems did not provide cooperatives with any autonomy. When cooperatives are taken as an independent entity from the government, but considered nonetheless as influential in the economy, the Government may limit itself to licensing, supervision and inspection. Cooperative Banks are good examples of this latter scenario.<sup>22</sup>

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<sup>21</sup>See our discussion in chapter four under principle of cooperation

<sup>22</sup> See Rajkamal Iyer, 'Regulation of Cooperative Banks in India' (2005) 40(50) Economic and Political Weekly 522-524

### *Indirect state control*

Indirect control is the result of the Government's belief that cooperatives are an expression of an individual's right to freedom of association. This means that if the government passes a law that realizes a freedom of association it then considers its implementation a private, rather than a public, issue.<sup>23</sup> In this case, the role of Government is to issue cooperative law that define cooperatives and establish and organize a state organ that registers cooperatives. Since the law defines cooperative form of association as distinguished from other form of association there would not be confusion. The definition of cooperative may emphasis the ultimate end of the cooperatives, i.e. cooperatives may be defined as an economic association working for non-profit motive. If the government wants to encourage a certain sector of cooperatives working for non-profit motives, it may give privilege based on the actual outcome.

## **8.2 Regulations of cooperatives in Ethiopia**

In the case of Ethiopian cooperatives, there is neither self-regulation nor state regulation. Members of cooperatives in Ethiopia do not have sufficient reason to cooperate and there is no cooperation between cooperatives. The Ethiopian Government lacks a definitive reason to back the cooperative campaign and does not allow cooperatives space to regulate themselves. The analysis these points are framed under the separate headings of self-regulation and state regulation.

### **A. Absence of self-regulation of cooperatives in Ethiopia**

The excessive interventionist ideology and behaviour of the State has denied members of cooperatives a reason to self-regulate or to be regulated. Since the Government has acted as the 'cooperator,' cooperative members do not see their role in the cooperative movement. This intervention by the Government combined with the infancy of the cooperative movement in Ethiopia has also led to the non-emergence of apex organization that would have assisted the development of the cooperative movement.

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<sup>23</sup>Compare this concept with the concept of criminal law and contract law. The government is duty bound to take direct and immediately responsibility for the prosecution of the violator of the criminal law whereas parties to a contract are responsible to bring their dispute to court and prove their allegation-the role of the state is limited to issuing laws governing contract; adjudicating disputes on the basis these laws if brought to it and then enforce its decision on the dispute if the winner expressly requests its enforcement.



### *Lack of motivation*

Motivation is a crucial factor in self-regulation and it may emanate from ideological, self-interest or altruistic moral concern.<sup>24</sup> However, none of these motivations exist in Ethiopia mainly because the Ethiopian Government, like many other Governments in Africa, have had authoritarian tendencies leaving little room for individuals to take responsibility for their own life and the life of their fellow citizens and have had total control over cooperative development allowing little room for individuals to take responsibility within the movement. With the exception of saving and credit cooperatives and dairy cooperatives, others in Ethiopia are constructions of the Government. The Government has master minded their formation and existence. As a result of this interventionist approach by the Government in stultifying individual initiative there is a lack of motivation for individuals to create or maintain true cooperatives in Ethiopia. This point is developed below.

### *The Ethiopian Government's interventionist ideology*

Since African leaders have a tendency to underestimate the capacity of their citizens to find solutions to their own problems, the state diagnoses its citizen's problems and then seeks to prescribe a remedy.<sup>25</sup> The theory of a developmental state has served as a theoretical and scientific justification for their actions.<sup>26</sup> This has formed a tendency for states to deny cooperatives their true ideological independence.<sup>27</sup> True and autonomous cooperatives are associations of people who are able to diagnose their own problems and solve these problems themselves. In a country where the legitimate body to resolve problems of individuals and citizens is a political organ of the Government, these cooperatives do not have this autonomy. The major reason why true and autonomous cooperatives emerged in Britain and spread in Europe, America and Asia was because the State was reluctant to solve the defects of a market economy which led to the misery of labourers and low income earners. If it could be understood by the Ethiopian Government that there could be a separate ideological basis for cooperatives

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<sup>24</sup>See our discussion in section 8.1 of this Chapter

<sup>25</sup>This is probably because they consider the formal modern western education as only source of problem solving knowledge and skill and most ordinary Africans in general and Ethiopia in particular lacks such formal education.

<sup>26</sup>Thandika Mkandawire, 'Thinking about developmental states in Africa' (2001)Cambridge Journal of Economics 289-313

<sup>27</sup>Cooperatives that exist in this ideology are mainly misnomers since they are mostly instruments of a state to attain its own agenda. This is indicated in the next subtopic in this Chapter

then this would leave room for an individual to take responsibility for their success. The issue of self-interest exists only if individuals are taking responsibility for their own fate. Philanthropic altruism also exists only if there is some in need and without any one to look after him. According to an informant there are no philanthropists supporting cooperatives in Ethiopia except Ethiopian Women Self-Help Saving and Credit Cooperative Movement.<sup>28</sup>

Since the Ethiopian government claims to be developmental state and has had already intervened into the economy to solve the problems of the market economy according to its own designs, there is no reason for individuals to be members of cooperatives and adhere to their principles. The major reasons for propagating true cooperatives are to enable small farmers to benefit from new markets created by forming producers' cooperatives, protecting consumers against high prices and low quality goods, helping the poor to get fair employment and providing residential houses for urban low and middle income earners.<sup>29</sup> But in Ethiopia the Government has already established the commodity exchange that serves as an alternative market for smallholder peasants and pastoralists. It also regulates the price and distribution of consumer goods. Moreover, there are three public enterprises, one cereal dealer and two manufactured product dealers that play a great role in market control.<sup>30</sup> Since, Ethiopia is an agrarian country where about eighty-five percent of the population lives in rural areas, the issue of employment rights is less crucial. Moreover; the Government, in addition to being a major employer, also takes the initiative to create jobs and to make jobs more conducive to employees through legislative means such as making it mandatory to have a pension and ensuring that every employee has health care insurance.

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<sup>28</sup> Interview with Daniel Legesse, Interview with Addis Ababa Saving and Credit Cooperative Union Ltd, General Manager' (3 August 2014) Unpublished. In its nine month performance report of April 2013 to the House of Peoples Representative the Federal Cooperative failed to mention anything about the success or failure of its plan to anchor cooperatives with charities. This implies that the Commission did not succeed in meeting its plan. (See Response of the Agricultural Committee of the House to the report of the Commission).

<sup>29</sup> Johnston Birchall, *Cooperatives and the Millennium Development Goals* (2004) Geneva International Labour Office <<http://www.aciamericas.coop/IMG/pdf/2004-birchall-mdgs.pdf>> accessed 30 January 2015, 3; Gerald Sazama, 'Lessons from the History of Affordable Housing Cooperatives in the United States: A Case Study in American Affordable Housing Policy' (2000) 59(4) *American Journal of Economics and Sociology* 573-608

<sup>30</sup> The cereal dealer is the Ethiopian Cereal Trade Enterprise and the others are Ethiopian Import and Wholesale Enterprise and the Ale Bejimla Enterprise. These enterprises have branches in major towns of the country and they may open additional branches if they need.

The residential housing problems in urban areas have seen the Government start a condominium project in 2004.<sup>31</sup> The Ethiopian Government designed the 20/80 urban housing project in 2004 and has been implementing the project since then. Since 2013, an additional two projects have been designed; 10/90, 40/60. The project name is based on the advance payment that is to be made by the person who gets the chance to buy the house from the Government at its construction cost. In 20/80 condo houses the advance payment is twenty percent of the construction cost and 40/60, forty percent and 10/90, ten percent. According to the terms of the project, the Government constructs condo houses and transfers the ownership of the houses to the person who pays a certain percentage of the construction cost in advance, and enters into a long term loan agreement with the Commercial Bank of Ethiopia for the remaining percentage. Therefore, in Ethiopia although individuals may be enthusiastic to be a member of ‘housing cooperatives’ they are in fact are misnomers.

There are only two reasons why individuals could be interested in joining ‘housing cooperatives’ priority access to urban land and administrative convenience. In the past although lease-price-free urban lands used to be given to individuals, ‘housing cooperatives’ used to be better treated as compared to individuals in terms of the amount of money deposited as a capacity indication and priority to access. Currently, even though individuals are totally denied the privilege to access lease-price-free urban land, housing cooperatives’ privilege is still maintained in law and in practice.<sup>32</sup> The other reason why individuals prefer to join housing cooperatives is because it would reduce administrative inconvenience. Individuals are not expected to personally apply for a land grant. A few individuals work as agents for the many. But on the part of the state, the purpose of housing cooperatives is to reduce the possibility of dealing with too many individuals.

Individual’s or philanthropist’s use of cooperatives has been best in areas like dairy farming and the saving and credit sector of the economy where the Government was not providing better alternatives. In Ethiopia, small scale dairy production is an important source of cash income for

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<sup>31</sup> Condo houses seem to be preferable to housing coops. See Michael Schill, Ioan Voicu, Jonathan Miller, ‘The Condominium versus Cooperative Puzzle: An Empirical Analysis of Housing in New York City’ (2007) 36(2) The Journal of Legal Studies 275-324

<sup>32</sup> Individuals could have access to urban land for residential house through lease auction only. Those individuals who are unable to afford the auction system are accommodated under the housing project of the government. Urban Lands Lease Holding Proclamation No. 721/2011 <<http://chilot.me/2012/01/11/new-urban-lands-lease-holding-proclamation-no-721-2011/new-land-lease-proclamation-no-721-2011/>> accessed 30 January 2015, Art 12(1)(c)

subsistence farmers but <sup>33</sup>they face many hidden costs that make it difficult for them to gain access to markets and productive assets.<sup>34</sup> Among other things;

*“costs of searching for a partner with whom to exchange, screening potential trading partners to ascertain their trustworthiness, bargaining with potential trading partners (and officials) to reach an agreement, transferring the product, monitoring the agreement to see that its conditions are fulfilled, and enforcing the exchange agreement” are some of the major problems that small scale milk producers face.*<sup>35</sup>

In the absence of state intervention in support of these small scale dairy farmers, it has been necessary to have a ‘farmer-led cooperative that handles input purchasing, distribution and output marketing, usually after some form of bulking or processing.’<sup>36</sup> There are no Government arranged market alternatives to dairy farmers in Ethiopia.

Similarly, loans are not easily available in Ethiopia especially to ordinary households and small holders. This is due to two main reasons, the nature of banks and Government regulation of bank loans. Banks are usually unwilling to extend loans to smallholders either because of the high costs associated with administering spatially dispersed small loans or smallholders; especially to low income earners who could not develop an acceptable project proposal, or have the necessary collateral to guarantee the repayment of the loan. The problem of collateral is more severe for Ethiopian smallholder farmers since land is a public property and a farmer has no right to present it as collateral. The Government has the policy of prioritizing bank loans since Ethiopian banks do not have sufficient liquid capital to grant all loan applications. One of the major challenges of Ethiopian economy is low level of domestic savings to support the huge demand of the country’s

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<sup>33</sup>See Garth Holloway, Charles Nicholson and Chris Delgado, ‘Agro-industrialization Through Institutional Innovation: Transactions Costs, Cooperatives And Milk-Market Development In The Ethiopian Highlands’ (1999)23(3) Agricultural Economics 3-10

<sup>34</sup> Ibid

<sup>35</sup> Ibid

<sup>36</sup>Ibid; See also Gian Francesconi and Ruben Ruerd, ‘The Hidden Impact of Cooperative Membership on Quality Management: A Case Study from the Dairy Belt of Addis Ababa’ (2012)1(1) Journal of Entrepreneurial and Organizational Diversity 85-103

investment for accelerating growth and development.<sup>37</sup> Thus the National Bank of Ethiopia issues directives indicating investment projects that have been given priority by the commercial banks. The projects that receive priority access to loans are big projects such as manufacturing, large scale farming, five star hotels. This forces ordinary households and small holders to search for other alternative sources due to the limited availability of funds for lending on the banks part. Saving and Credit cooperatives would be one of these alternatives.<sup>38</sup> Credit cooperatives can lend to individuals whom banks are unable to.<sup>39</sup> There is no law in Ethiopia that empowers the National Bank of Ethiopia to interfere or regulate cooperatives and thus the credit cooperatives can decide their own terms for lending. Relative to other types of cooperatives in Ethiopia, Ethiopian saving and credit cooperatives are closer to true cooperatives since they adhere to the mutuality principle of user control, user ownership, and user benefit.<sup>40</sup> This would imply that individuals have sufficient reasons to be bound by the cooperative principles.

### *Absence of Cooperative Ideology in Ethiopia*

With the exception of saving and credit cooperatives and dairy cooperatives, all other types of cooperatives in Ethiopia are not genuine. In true cooperatives, the members recognize their own economic problems and they then decide that cooperatives are their best alternative to be out of the problems. They have autonomy not only in its daily management but also in identifying longer term problems and finding solutions. True and autonomous cooperatives are alternatives to State public enterprises and investor-owned firms. In public enterprises, the State is both the entrepreneur and the investor and profit is not its primary agenda. In investor-owned firms, the entrepreneurs and the investors may not necessarily be the same and profit is the primary and ultimate objective. Like public enterprises, in true and autonomous cooperatives entrepreneurship and ownership overlaps and profit is not an ultimate end.

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<sup>37</sup>Ministry of Finance and Economic Development, 'Ethiopian Growth and Transformation Plan'(2010) <<http://www.mofed.gov.et/English/Resources/Documents/GTP%20English2.pdf>>accessed 30 January 2015, 3

<sup>38</sup> See Abhijit Banerjee, Timothy Besley, Timothy Guinnane, 'The Neighbor's Keeper: The Design of a Credit Cooperative with Theory and a Test' (1994) 109(2) The Quarterly Journal of Economics 491

<sup>39</sup>Timothy Guinnane, 'Cooperatives as Information Machines: German Rural Credit Cooperatives 1883-1914 (2001)61(2) The Journal of Economic History 366, "Economists now appreciate that resource allocation in less developed economies is influenced by non-firm economic institutions such as credit cooperatives;" See Ibid.

<sup>40</sup> This researcher is currently a member of Hawassa College of Agriculture Saving and Credit Cooperative. He noticed that this credit cooperative adheres to cooperative principles. In a statement she gave to *Addis Zemen* (state owned Amharic daily newspaper) on Yekatit (February) 4(11) 2006 (2014) a representative of Addis Ababa Saving and & Credit Cooperative Union also concluded that saving and credit coops show allegiance to cooperative principles.

However, in cooperatives in Ethiopia, it has been the State that identifies social and economic problems and also proposes cooperatives as a solution to the problem.<sup>41</sup> The members of these cooperatives neither self-identify problems nor propose solutions for the claimed problems. It is the Government that has taken this initiative in the cooperative movement. The reason is partly historical. Cooperatives were first introduced in 1960s by the imperial government to bolster the agricultural production of the country by organizing the unemployed labourers into them. The socialist government continued the State led movement in order to use the cooperative societies as a means to build socialism. Although the Ethiopian economy was liberalized after 1991, the Government has remained the leader of the cooperative movement in the belief that cooperatives can be utilized as a means to solve challenges to economic and social development.<sup>42</sup> One of the major tasks of the Cooperative Agency or the Cooperative Commission is expanding the cooperative movement and cooperative ideas. The government may develop a project and organize individuals into cooperatives to implement the project. Small scale coffee producer cooperatives and consumer cooperatives (especially in urban areas) are typical examples in this respect. For example, to protect small hold coffee farmers against checks with insufficient cover and to encourage and to control the coffee export (which is the major source of foreign currency for the Government) the Government has organized farmers into primary cooperatives and cooperative unions.<sup>43</sup> Similarly to fight inflation and to control the price and distribution of basic goods<sup>44</sup> the Government has been organizing consumers into consumer cooperatives.<sup>45</sup>

Housing Cooperatives are also initiated by the Government to reduce the burden of administration. Housing cooperatives are essentially a mechanism for collective filing of urban land requests. Indeed, I have personal experience of ‘housing cooperatives’ having been a member of the Dirshaye Housing Coops Ltd established in Hawassa in 2004. As it has been the

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<sup>41</sup>Legesse (n 27); See also our discussion of the Government using cooperatives as policy instruments in Chapter Seven.

<sup>42</sup> See our discussion under Chapter One

<sup>43</sup>Interview with Gadissa Eda’a, Ayele Bedane, Girma Regassa, ‘Interview with the Finance Head, Certificate Officer and Head of Legal Services at Oromia Coffee Farmers’ Cooperative Union’ (8 March 2013) Unpublished

<sup>44</sup>For the definition of basic goods/service see Trade Practice and Consumers’ Protection Proclamation No. 685/2010 <<http://chilot.files.wordpress.com/2011/01/685-ae.pdf>> accessed 30 January 2015, Art 2(1), 46 and 55.

<sup>45</sup>Tesfaye Matewos, ‘Interview with the Cooperative Societies’ Organization and Registration Officer at the Marketing and Cooperatives Office of the Hawassa City Administration’ (25 June 2014) Unpublished; Fikre Mekuria and Mierab Kolfe, ‘Interview with the Board Chairpersons of the Consumers’ Cooperative Union Ltd’ (5 August 2014) Unpublished; Mulugeta Mengistu, ‘Interview with the Head, Promotion and Development at the Work-Process Main Unit in the Cooperative Promotion and Development Sector of the Trade and Industry Bureau of the Addis Ababa City Administration’ (3 August 2014) Unpublished

case in all other housing cooperatives this was established by the request, if not order, of the Municipality. Based on such demand from the municipality, individuals who were interested in accessing land on smooth line<sup>46</sup> took the initiative and did the following. First, they collected draft by-laws from Cooperative Department, Agriculture Bureau, State of Southern Nations, Nationalities and People. Second, they listed down twenty-four individuals who wanted to become a member. Thirdly, they called a general meeting. In the meeting organizers did two things; one, got each member's signature on the already prepared minute; two, they ordered each member to deposit in the cooperative's blocked bank account four thousand birr (the amount fixed in advance by the Municipality as construction capacity indicator<sup>47</sup>) to be opened after the signature of the minute in the Commercial Bank of Ethiopia. Fourthly, got the registration of the cooperative by showing the minutes of the 'general meeting' and a bank statement that indicated the deposited amount. And finally, they got the urban land lease holding title deed and possession of the land from the municipality without paying the land lease price. After the land was obtained the land was divided among members and each individual took responsibility for constructing a house of his own design and size. A member who completed a certain percentage of construction required as a condition for release of the money deposited in the blocked account, would automatically get an individual title deed for the land he already possessed. At no point is there a fund owned by the cooperative. There is no reason to treat such an arrangement as true cooperative. It is simply a simpler way of administering land titles.

The current housing cooperatives that have been receiving lease-price-free urban land in the state of Amhara<sup>48</sup> do not show any difference from their predecessors. The housing cooperatives in Addis Ababa are expected to pay the full cost of construction in advance even before they receive the ownership and the possession of the house. The house would normally be constructed by the government. It is difficult to call such associations 'cooperatives' since they are united only by the deposit of money and ownership is transferred to the cooperative and then transferred to individual members. It is nothing but an unnecessary channel through which money passes from an individual to the Government and ownership passes from the Government to individuals.

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<sup>46</sup> There were individuals who made request for urban land on individual basis and got positive response. Put this in the text

<sup>47</sup> Although there is no express legal requirement in the Urban Land Lease Law both state and federal governments in Ethiopia do not allow urban land holding unless they believe that the would be land holder has enough money to construct the necessary construction on the land.

<sup>48</sup> Other states do not seem to give lease-price-free urban land to 'housing cooperatives.'

It is also worth noting that housing cooperatives are not expected to serve the lower and middle income earners. They are intended for the petty bourgeoisie so that they may not be a burden on the State in accessing residential houses. The Government has already taken the responsibility to resolve the residential housing problems of lower and middle income earners. The Ethiopian Housing project seems to classify house seekers into four categories on the basis of their financial capacity; those who can afford both market lease price and market construction price (obtain land through auction and make their own construction or purchase house from real estate), those who afford advance payment of full construction cost but wait for the Government to construct them (housing cooperatives), those who pay in advance forty percent of the construction cost, those who pay in advance twenty percent of the construction cost and those who pay in advance ten percent of the construction cost. So, housing cooperatives, in their current sense, are far from the idea of true cooperatives. In true housing cooperatives the cooperative construct the houses and own them or at least transfers the ownership to the members.

#### *Lack of Cooperation*

Most cooperatives in Ethiopia have been established at local level and are usually small.<sup>49</sup> Most saving and credit cooperatives have been established within a limit of a premise of an employer of members of a cooperative.<sup>50</sup> That means saving and credit cooperatives are usually established by employees and their members are mostly employees working for the same employer. Therefore, unless there is a forum that brings together these scattered and isolated movements in the spirit of cooperation, the cooperative movement will not have the necessary momentum to mature and develop principles. Cooperation would be possible if cooperatives were strictly committed to the principles of cooperation. Then they would be able to create an apex organization that might further facilitate cooperation between the different groups.

However, cooperatives in Ethiopia seem uninterested in this.<sup>51</sup> There are a lot of cooperatives that have profit maximization motives and these cooperatives are usually less willing to bind

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<sup>49</sup>Legesse (n 27)

<sup>50</sup> Ibid

<sup>51</sup>Mekuria (n 45); Ibid



themselves to cooperative principles unless there are clear economic benefits.<sup>52</sup> Moreover, members of cooperative management boards stake little importance on principles.<sup>53</sup> There has also been misunderstanding and disagreement as to whether cooperation could be possible among different types of cooperatives (producer, consumer or worker) and even among cooperatives in different sectors of the economy (e.g. coffee, dairy, traditional mining, weaving, etc).<sup>54</sup> This lack of cooperation has also resulted in the absence of apex organizations.<sup>55</sup>

The Government's leadership of the cooperative movement has also been the major reason for absence of apex. The government does not seem to show a desire to deal with larger and more organized cooperatives for fear that such cooperatives would easily escape its control.<sup>56</sup> Even in cases where cooperative consensus is established to create an apex organization at regional or national level, the Government repeatedly refuses to register the organization.<sup>57</sup> The Government wants to remain the only apex organization. More surprisingly, the Federal Cooperative Agency has been representing Ethiopian cooperative movement in the international cooperative movements.<sup>58</sup> As a result cooperation has been practically possible only in the zonal level in the form of a cooperative union.<sup>59</sup>

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<sup>52</sup>Ibid

<sup>53</sup>Legesse (n 27)

<sup>54</sup> Ibid; This misunderstanding could also be attributed to lack of awareness of cooperative ideology. As far as there is consensus on principles of cooperatives the sector of the economy or even the types of the cooperatives is less important for cooperation. Comments like this should either be in the main text or not here at all.

<sup>55</sup>Ibid

<sup>56</sup>Tesfaye Wami, 'Interview with the Legal Advisor and Promoter of Inspection, Audit and Legal Services at the Work-Process Main Unit in the Cooperative Promotion and Development Sector of the Trade and Industry Bureau of the Addis Ababa City Administration (4 August 2014) Unpublished

<sup>57</sup>Mekuria (n 45); Legesse(n 27); Michael Ayalew, 'Senior Legal Expert of the Federal Cooperative Agency'(24 February 2014) Unpublished

<sup>58</sup>Legesse(n 27)

<sup>59</sup>An exception to this is only the Oromia Coffee Farmers' Cooperative Union Ltd. Zone is the third from bottom up or second from up down in Ethiopian geopolitical administrative structure. It is equivalent to sub-city in the case of the City Government.

## B. Absence of state regulations of cooperatives in Ethiopia

In Ethiopia, although the Government uses cooperatives as policy instruments and, believes that cooperatives are partly dependent on the Government,<sup>60</sup> there is no legal framework that authorizes the Government to interfere with their internal affairs.

### *Cooperative principles without legal effect*

Cooperative Society Proclamation No.147/1998 provides principles, however, the consequence of the violation of these principles is unclear. Although it could be argued that a proclamation is a law and the Government has the constitutional duty to enforce all laws of the State,<sup>61</sup> such an argument would be weak because there is no provision in Ethiopian cooperatives law that implicates any administrative measure against the violation. The only measure the Government may take is refusal to register those cooperatives that fails to include the principles in their constitution.<sup>62</sup>

One may argue that interested persons may apply to the court to force the cooperatives to adhere to the principles. However, this is difficult, if not impossible, for at least three reasons. The first problem is uncertainty about who the interested person is and who the responsible person is.<sup>63</sup> In case of the principle of open membership the interested person may be those whose application for membership was rejected by a cooperative. But in case of other principles such as

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<sup>60</sup> According to the Government the reason why cooperatives are partially dependent on the government is because they are not mature enough to be autonomous. Until they are mature enough, the Government is serving them as guardian and tutor. On the other hand the cooperator believes that since the government has unable to solve some economic problems it has requested the cooperatives to help solve the problem. one thing that both the Government and cooperators agree to are; cooperatives are partly dependent and they will be fully autonomous; Mengistu (n 45); Wami(n 56); Mekuria (n 45)

<sup>61</sup> Constitution of the Federal Democratic Republic of Ethiopia 1995

<<http://www.refworld.org/docid/3ae6b5a84.html>> accessed 30 January 2015, Art 77(1); However; some may take the view of Hans Kelsen about the meaning of law. According to him law is an order of a superior official to the inferior official. This means the law exists only if the official wants its enforcement. Otherwise we have to assume as if it has not been written.

<sup>62</sup> Council of Ministers' Regulation No.106/2004

<<http://www.joptc.gov.et/joptc/LinkClick.aspx?fileticket=0GpIFfh5Zzs%3d&tabid=109&portalid=0&mid=535&language=en-US&forcedownload=true>> accessed 30 January 2015, Art 14(a)

<sup>63</sup> No person may be a plaintiff unless he has a vested interest in the subject-matter of the suit. No person may be a defendant unless the plaintiff alleges some claim against him. See the Civil Procedure Code of the Empire of Ethiopia of 1965<[http://www.ras-tafari.com/documents/EN\\_Civil\\_Procedure\\_Code\\_of\\_the\\_Empire\\_of\\_Ethiopia\\_1965.pdf](http://www.ras-tafari.com/documents/EN_Civil_Procedure_Code_of_the_Empire_of_Ethiopia_1965.pdf)> accessed 30 January 2015, Art 33(2) and 33(3)

voluntariness (assisting each other & self-responsibility), democratic control, autonomy, cooperation and sustainable development<sup>64</sup> a cooperative may be unable to adhere to the principles due to the acts or position of individual members. For example, those who hold more shares may influence those who hold fewer shares and neutralize the principle of democratic control. The cooperative is interested in maintaining democratic control but is at the same time responsible for failure to create an environment that nurtures democracy. Similarly a member is responsible either for influencing or being influenced. The law does not clearly indicate voluntariness (assisting each other and self-responsibility) as a legal duty of members.

The second problem is the incomplete recognition of cooperative principles by the Ethiopian Cooperative laws. The principle of surplus distribution on the basis of share capital and the possibility of inviting capitalists into membership cloud democracy. The vaguely regulated government assistance, especially access to land and loan, affects the interpretation of principle of autonomy.<sup>65</sup> In short, the vagueness of the law, combined with low level of rule of law in the country, makes individual legal action difficult.

The third problem is the nature of cooperatives. Cooperatives by their nature do not depend very much on contract law and legal professionals. They depend on voluntariness and cooperation. The ethics of individual members is the crucial instrument for the enforcement of cooperative principles. They are the opposite of investor-owned firms which depend heavily on contract law and legal professionals for advice. Legal professionals are more in favour of competition rather than cooperation through collective action. That is why the Ethiopian cooperatives law advises member or manager to refer disputes to conciliation and arbitration.<sup>66</sup> So, the judicial system

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<sup>64</sup>Although there is environmental impact assessment and control agency that ensure that investors adhere to the principle of sustainable development cooperatives could possibly escape the control since they do not need to have investment permit and business license to implement their business project. See Cooperative Society Proclamation No.147/1998<<http://chilot.me/2011/11/22/cooperative-societies-proclamation-no-1471998/>> accessed 30 January 2015, Art 9(6) as amended by Cooperative Societies (amendment) Proclamation No.402/2004<<http://chilot.me/2011/10/30/cooperative-societies-amendment-proclamation-no-402-2004/#more-2296>> accessed 30 January 2015; Environmental Laws of Ethiopia Proclamation No.295/2002<<http://phe-ethiopia.org/resadmin/index.php?attachment=40>> accessed 30 January 2015, Art 6(5), and Environmental Impact Assessment Proclamation No. 299/2002<<http://phe-ethiopia.org/resadmin/index.php?attachment=41>> accessed 30 January 2015, Art 3(3)

<sup>65</sup>Special privileges of cooperatives are discussed in Chapter Three, Section 3.1

<sup>66</sup> See Ethiopian Cooperative Law Art 46 as amended by Proclamation No. 402/2004 (n 64)

would contribute less to enforce cooperative principles. Also, many legal professionals prefer to leave cooperatives to self-regulate.<sup>67</sup>

### *Indiscriminate special privileges*

Ethiopian cooperative law recognizes many special privileges for cooperatives. However, since such privileges are given to everybody registered as a cooperative, and the definition of cooperatives is not precise enough,<sup>68</sup> it is impossible to limit such privileges to true cooperatives or cooperatives that serve as policy instruments of the Government.

In practice, the distinction is more difficult. For example, an informal interviewee, an officer who was in duty to register cooperatives in Hawassa City Administration in 2011, asserted that the important matters to be registered as cooperative were the number of members (the number should be more than ten) and the decision of the members to be registered as a cooperative.<sup>69</sup> According to this interviewee, it is up to the members to decide to be registered either as an investor-owned firm, a cooperative, or even as a charity. In another formal interview in June 2014, another employee in the same position claimed that membership in cooperatives is possible only for low and middle income earners although members are not required to prove their income.<sup>70</sup> The absence of proof of income<sup>71</sup> and the fact that cooperatives in general and consumer cooperatives in particular are non-discriminatory on the basis of the economic condition make the criteria to be ineffective and unacceptable. Furthermore, the criteria have nothing to do with blocking profit-seekers, what it blocks is the rich, if it can. In Addis Ababa,

<sup>67</sup>Wami(n 56); In a public discussion held on Proclamation No.147/1998 (n 64) the drafting committee members were asserting that the cooperative principles indicated in the law are not legally binding on the cooperatives; it is up to them to accept or reject. These committee members were even claiming that the Proclamation No.147/1998 as a whole is not binding unless approved by regional governments.

የህብረት ትስፋ መሣሰብ ስር ስለሚገኝ ማዕቀብ ተዘጋጅቶ ሲሆን ለዚህ ምክር ቤት የህብረት ስራ ዓመት 1991 ዓ/ም ገጽ 4 ነው።

<sup>68</sup> See Chapter Three, Section 3.2

<sup>69</sup> This interview was made while this researcher and other five individuals were discussing to establish a fishing farm and were arguing on the form of ownership of the farm. Although all the members were academic staff members of Hawassa University and intended to maximize profit they except this researcher were preferring cooperative form of ownership and the interviewee supported their preference. However; the farm failed for other reasons.

<sup>70</sup>Matewos(n 45)

<sup>71</sup>Which is in fact impossible or at least inconvenience due to absence of definition of the income level in Ethiopia

residence is the only criteria.<sup>72</sup> The abolition of worker cooperatives in Addis Ababa resulted from the lack of clear guidelines to stop profit-seekers using cooperatives.<sup>73</sup>

### *Cooperative Commission power limited*

Although there are Government agencies that are concerned with cooperatives the duty of these agencies is limited to supporting cooperatives. For example, the powers and duties of the Federal Cooperative Commission are to:<sup>74</sup>

- Formulate and draft cooperative policies and laws suitable for the activities and development of cooperatives.
- Encourage cooperatives to adhere to Cooperatives law and established international principles for cooperatives.
- Organize and supervise Government owned cooperative training institutes.
- Disseminate cooperative ideology.
- Register cooperatives in the federal level.
- Audit and inspect federal cooperatives.
- Search market for cooperatives.
- Provide professional and technical support to cooperatives.
- Assist regional cooperative agencies.
- Facilitate cooperation in the regional and international level.
- Formulate and distribute model by-laws of societies.

The supervision and audit is limited to protecting the property of cooperatives against embezzlement. The Government inspector checks the existence of necessary management organs, office organization, staffs and materials, meetings and records.<sup>75</sup> But they are limited to

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<sup>72</sup>Mengistu(n 45)

<sup>73</sup>Birke Melaku, 'Interview with the Cooperative Promotion and Development Coordinator' (4 August 2014) Unpublished; Abinet Melese, 'Interview with the Senior Cooperative Promoter in the Cooperative Promotion and Development Work-Process Main Unit of the Trade and Industry Sector in Arada Sub-City of the Addis Ababa City Administration' (4 August 2014) Unpublished

<sup>74</sup>Cooperative Commission Establishment Proclamation No. 274/2002

<<http://www.fsc.gov.et/resources/Negarit%20Gazeta/Gazeta-1994/Proc%20No.%20274-2002%20Cooperatives%27%20Commission%20Establishment.pdf>> accessed 30 January 2015, Art5 (emphasis added)

<sup>75</sup>Wami(n 56)

giving comments to the management committee and reporting their findings to the Commission.<sup>76</sup> The commission may send an auditor who also give comment to the cooperative and report his findings to the commission.<sup>77</sup> If the auditor's finding shows some form of corruption, the commission would institute a court action against those responsible.<sup>78</sup>

### *Principle of autonomy*

Ethiopian cooperative law expressly recognizes the principle of autonomy.<sup>79</sup> Moreover, many employees of cooperative agency repeatedly reinforce the claim of cooperative autonomy. They claim that anything that the Government does to or for cooperatives is merely supportive and their internal affairs are left to the cooperatives to themselves. This claim of autonomy, however, contradicts the Government plan (however ultimately unsuccessful) of using cooperatives as a policy instrument. If the Government cannot control cooperatives, at least in some form, it is difficult (if not impossible) to direct them to that intended mission and goal. Moreover, this claim of autonomy encourages rent seekers to misdirect the special privileges of cooperatives for unintended purposes and Government officials may also avoid their responsibility of giving special privileges for unintended purposes.

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<sup>76</sup> Ibid

<sup>77</sup> Ibid

<sup>78</sup> Ibid

<sup>79</sup> See Chapter Four

### 8.3 Conclusion

This chapter is our last attempt to find important points that distinguish cooperative from investor-owned firms in Ethiopian Legal System but our attempt is unsuccessful.

In chapter one, we distinguished cooperatives from investor-owned firms on the basis of the ultimate motives. Cooperatives have not-for-profit ultimate motives whereas the ultimate end of an investor-owned firm is profit-maximization. In chapter two, we saw that the cooperative form of organization does not necessary involve not-for-profit motives. Here it was argued there should be other criteria to keep cooperatives distinct from investor-owned firms. What that criterion might be was discussed in chapter three to eight together with further discussion of the immense privileges which are available to cooperatives but are not available to other form of economic organizations. We have analyzed definition, the objectives and principles of cooperatives and ownership and management in chapter three, four, and five under the Cooperative Society Proclamation No.147/1998. However, it appears that there is little here to distinguish cooperatives from investor-owned firms. Then we resorted to policy analysis with the hope that the Government policy objective of cooperatives may be different from investor-owned firms. It is not. In chapter seven and eight examined practice to see if that might reveal a distinction. In chapter seven we examined what Cooperatives in Ethiopia are actually doing and we found out that although the government is trying to use them as policy instruments they are profit-maximizing economic organizations.

In this last chapter, chapter eight, we looked at the regulation of cooperatives and found out that cooperatives in Ethiopia are essentially unregulated. One of the important points that distinguish cooperatives from investor-owned firms is that cooperatives should always be regulated. Historically, self-regulation has been inherent to the character of cooperatives. State regulation may also exist.

Self-regulation is possible when individual members have strong motives for cooperation, when for example they have seen the value in collective action to solve individual problems. However, in Ethiopia individuals are not allowed the responsibility to solve their own problems in their own way. It is the state that solves the problems in its own way.

In its effort to solve economic problems the Government has also been utilizing cooperative forms of organization. This means the Government has taken center stage in cooperative formation. This has seriously affected the emergence of a commitment and belief in the ideas of cooperativism. The absence of cooperative ideas also negatively affects cooperation acting together. Cooperation between cooperatives reinforces commitment, knowledge and motivation to cooperate. Motivation, then, leads to self-regulation.

In the absence of self-regulation we might expect state regulation. However the Ethiopian Government declines to regulate cooperatives. Cooperative principles without legal effect, indiscriminate special privileges, the limited power of cooperative commission and the recognition of principle of autonomy are indicators of little or non-existent state regulation.

Generally, this research indicates that the Cooperative Society Proclamation No.147/1998 as it stands is almost a repetition of the Commercial Code. Moreover, generally the cooperatives operating currently in Ethiopia are 'like' investor-owned firms. Both the law and the practice in Ethiopia do not warrant separate legal regime for cooperatives and investor-owned firms. If the separation between cooperatives and investor-owned firms is to continue, cooperatives should limit themselves to community building as their ultimate motive. The next two chapters show why we need to rebuild community and why the cooperatives would be the best to the task.



## **CHAPTER NINE**

### **TRUST AND ITS DECLINE**

#### **9.0 Introduction**

This chapter intends to prove that trust, which is a foundation of rule of law, has been diminishing due to a decline in religion and community. This is with the aim of searching for ultimate not-for-profit objectives that keep cooperatives distinct from investor owned firms. In Chapter One and Eight we have seen that cooperative have lost their traditional ultimate objectives and as a result have been led to profit-maximizing motive and lack of self regulation.

In order to prove the logical coherence of the above claims, the chapter is divided into five sub-topics. The first sub-topic proves that trust is the minimum universal morality requirement for human harmony. The second sub-topic indicates how important trust is for individuals and institutions emphasizing the place of trust in the enforcement of law. The third and the fourth sub-topic show that trust has been declining due to decline in religion, moral objectivism and community.

Although human relations are basically dependent on some form of trust, this fundamental assumption has been gradually declining. The major causes of this are the decline of religion, morality and community. In the past, people used to value trust because to be trusted was a religious or moral or customary duty. A person who failed to be trustworthy would be punished by God or his own conscience or by the community. But now, due to the rise of science, considerable sections of the modern society have already become atheists and moral norms have become subjective. Moreover, industrialization and urbanization resulted in high mobility of individuals and led to the declining of communities.

## 9.1 Trust and its role in human relationship

### A. Concept of Trust

Trust is “the expectation held by an individual or a group that the word, promise, verbal, or written statement of another person or group can be relied upon.”<sup>1</sup> Trust is a confident belief or strong hope that a person who has given his words to another would honor his words or that what he claims is what he really means and intends to do. This further means that there has been an agreement between ‘trustor’ (an individual or group that trust) and a target (a person or a group is trusted). The agreement necessarily imposes an obligation on the target. If the target does not have an obligation emanating out of the agreement there is no issue of trust. When the agreement imposes obligation on both parties to the agreement then trust becomes a mutual issue, both sides of the party depend on one-another’s trustworthiness.

Trust relates either to the ability or the value congruence of the target.<sup>2</sup> The ability of the target relates to “the perceptions of the competence, skill, or ability of the target in the performance of a task; and value congruence is the moral, ethics, integrity, and value orientation of the target.”<sup>3</sup> Our concern here is with value congruence. The point that makes trust very indispensable is the non-existence of a scientific mechanism or at least too much inconvenience of such mechanism to make sure that the target honors his words. If there has been any scientific mechanism which would conveniently applied to know what is really going inside the mind of human being or what a target claims is right or wrong trust is unimportant. For example, citizens do not have convenient scientific mean to know whether or not the politician running for office really intends to honor election campaign claims, whereas it is possible for an employer to prove the agreed upon expertise of an employee. Thus trust is relying on moral integrity of the target.

Although there is no scientific mechanism for verifying this, "moral integrity may be inferred from a rational calculation based on some criteria of evaluation (cognitive) and social

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<sup>1</sup>Olugbenga Ladebo, ‘Perceptions of Trust and Employees' Attitudes: A Look at Nigeria's Agricultural Extension Workers’(2006) 20(3) Journal of Business and Psychology 411

<sup>2</sup>Ammeter, Douglas, Ferris and Goka, ‘A Social Relationship of Trust and Accountability in Organizations’ (2004)14 Human Resource Management Review 47-65

<sup>3</sup>Ibid

identification and empathy or affective processes.”<sup>4</sup>The cognitive trust is an objective, rational, and methodical evaluation by a trustor concerning a target as being trustworthy.<sup>5</sup> Affective trust is believed to be subjective in nature because it relates to the feelings, mood or emotions that a trustor has concerning the target as being trustworthy.<sup>6</sup>A relationship may progress over a period, from that based on a cognitive trust to a point where the trusting parties develop a mutual emotional interest in each other (affective trust).<sup>7</sup>

## **B. No Trust No Human Relation**

Thomas Hobbes explains that it is in the nature of human being to be in conflict even where there is a difference in strength and power. For example, strong individuals may be defeated by the weak when the strong fall asleep. The fact that human beings have the mental ability to design ways and techniques that enable to create inconvenience to his enemies maintains a certain balance of power.<sup>8</sup> The other nature of human being is egoism. With this balance of power, rationality and selfishness, human being is destined to live in the planet where there is resource scarcity, argues Hobbes. This scarcity opens a room for fierce competition for resources where no one would be in a better position to defeat the other.

Unless there is some way of controlling this competition human being would live in a permanent state of war. “This logic of natural conflict has frequently been assimilated to the game-theoretical model of the prisoner’s dilemma.”<sup>9</sup> Human beings have a rational ability to be out of this dilemma and can easily recognize that “everyone would be better off if they were all to refrain from attacking one another.”<sup>10</sup> However, individuals would not be sure whether the other could also refrain from attacking.<sup>11</sup> So in addition to recognizing the importance of respecting

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<sup>4</sup>Sally Atkinson and David Butcher, ‘Trust in Managerial Relationships’ (2003)18(4) Journal of Managerial Psychology 282-304

<sup>5</sup> Mark Hansen, John Morrow, and Juan Batista, ‘The Impact of trust on Cooperative Membership Retention, Performance, and satisfaction: An exploratory study’(2002) 5 International Food and Agribusiness Management Review41-59

<sup>6</sup> Ibid 43

<sup>7</sup>Ferda Erdem and Janset Ozen, ‘Cognitive and Affective Dimensions of Trust in Developing Team Performance’ (2003) 9(5) Team Performance Management 131-135

<sup>8</sup> Contemporary terrorism may be an indication of this human equality where handful of individual groupings are challenging the whole world altogether.

<sup>9</sup>Patricia Springborg(ed)*The Cambridge Companion to Hobbe’s Leviathan*(1<sup>st</sup> edition, Cambridge University Press, 2007) 114

<sup>10</sup> Ibid

<sup>11</sup>Ibid

the right of others, individuals want assurance that the other would equally refrain from attacking. The concept of social contract emanates from this desire to get assurance about how individuals behave in their relation with other fellow individuals. In a social contract all individuals agree to refrain from attacking one another.

For Thomas Hobbes, the agreement to refrain from attacking one another means that individuals agree to delegate their natural right of self-defense to an absolute monarch. They agree that the monarch has every power necessary to stop individuals from attacking one another. According to Hobbes, individuals, if left to their own will, could never honor the terms of the social contract; individuals distrust each other and there is no logical reason to trust each other. Hobbes' theory was criticized for applauding dictatorship but we need to notice that it is the lack of trust between individual that forced him to recognize absolutism. So lack of trust may be a cause of tyrant rule.

Without postulating trust, the formation and effectiveness of the absolute government itself is questionable. It is very difficult to see the rationality of delegating one's natural right to a tyrant than to remain in the state of nature unless there is a trust on the tyrant that he would benevolently give back at least some of the natural rights. This means if there is no trust there would not be social contract. That is probably why absolute monarchial governments have been upholding the religion of the majority of their subjects or have been converting the majority of their residents into the religion they already upheld as state religion. The subjects would trust that the absolute monarch would show them benevolence at least to the bare minimum, for fear that God would punish him both in this world and after death for any injustice he would do to his subjects. To consolidate the trust of the subjects, religious fathers of the state religion preaches to the subjects that state is divine creation and the absolute monarch is the delegate of God. Even if the state may be formed by coercion,<sup>12</sup> it is still difficult, if not impossible, to run the state apparatus if the majority of the personnel are absolutely untrustworthy.

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<sup>12</sup>There are various theories on the origin of state this research postulates social contract theory (state emerges out of the free will decision of individuals to cooperate with each other) due to its contemporary dominance.. Other major theories are: natural theory-state is the dictate of nature revealed to human being through reasoning; divine theory – the state is the divine creation to carry out God's will on earth ;patriarchal theory – the state developed out of family relation; psychological theory- state emanates due to the psychological desire of some human beings to rule and others to be ruled; theory of historical materialism- state is the result of economic class struggle. See Aleksander Sheptulin, *Marxist-Leninist Philosophy*(2<sup>nd</sup> edition, Progress Publishers, 1978) 390-410

Unlike Thomas Hobbes, John Locke on the other hand postulates the existence of trust between individuals to develop his theory of social contract.<sup>13</sup> Such postulate enabled him to come up with democratic form of government that recognizes the sovereignty of the people. Locke postulates trust because he believes that human being has a moral integrity that would serve as basis for trust. “His bedrock premise is that a divine power exists in the universe.”<sup>14</sup> This divine power has a will regarding our action and it has communicated his will to us through the Bible and enforces such will with rewards and punishments after death.<sup>15</sup> Moral integrity is the Biblical obligation of individuals. Duty of moral integrity ensures trust. This trust further ensures the enforceability of social contract. In short Locke believes that religion ensures moral integrity and moral integrity in turn insures trust and trust then ensures rule of law.

Other social theories also presuppose the existence of trust although they may not necessary evoke religion as a foundation. For example, Rawls’ theory of Justice postulates that individuals would honor what they have agreed upon in the “veil of ignorance.”<sup>16</sup> Marxists also believe that any people’s collective action requires that all members of society should observe certain elementary rules of behaviour without which the existence of human society is inconceivable.<sup>17</sup> In practice also research has indicated that human relations are difficult, if not impossible, without trust.<sup>18</sup> Trust functions as “a deep assumption underwriting social order.”<sup>19</sup> “It is the mutual ‘faithfulness’ on which all social relationships ultimately depend.”<sup>20</sup> It is more basic for the constitution of solidary groups than even a sense of moral obligation.<sup>21</sup>

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<sup>13</sup> Greg Foster, *John Locke’s Politics of Moral Consensus* (Cambridge University Press, 2005) 31, 70 and 167

<sup>14</sup> Ibid

<sup>15</sup> Ibid 31-32

<sup>16</sup> John Rawls, *Political Liberalism* (Columbia University, 1993) 49

<sup>17</sup> Sheptulin (n 12) 457

<sup>18</sup> Olugbenga (n1) 409

<sup>19</sup> David Lewis and Andrew Weigert, ‘Trust as a Social Reality Social Forces’ (1985) 63(4) Social Forces 967

<sup>20</sup> Ibid 968

<sup>21</sup> Ibid

## 9.2 The benefits of trust

In the preceding sub-topic, we saw that trust is the foundation of human relations and that brings many benefits such as the emergence networks. Networks produce norms, further trust, and further networks.<sup>22</sup> These can be used as a springboard to improve educational performance, economic and health betterment, and prevention of crime<sup>23</sup> and in serving as a basis for the rule of law. Such benefits serve the network members, the community at large and the state.

### A. Improving educational performance

There is a close relation between people's social network and their educational performance.<sup>24</sup> Children whose parents have strong social connection usually show better educational performance than children whose parents have weak social connection.<sup>25</sup> Parents' strong social connection reduces the possibility of their children's school dropout and increases the possibility of better achievement, reading attainment and scientific literacy.<sup>26</sup>

The connection between social network and educational performance of children is commonsensical knowledge. There is high possibility that the persons with whom the parents have close relationship may help the children directly or indirectly such as providing or at least pinpointing relevant materials to be read or persons to be consulted on the matter. Such people may sometimes be experts in certain areas and may help the children with very less effort. Children also need role models and family connection helps them to get these role models. More importantly the ultimate end of education is to enable human being to understand his physical and human environment. Human interaction would help students to understand such matters very easily. The interaction created by the network would serve as a laboratory to identify problems and to prove the theories they learn in formal schools. The parents could also learn from peoples in the network on ways of leading their children to success.

Knowledge is obtained both formally and informally one supplementing the other. Those individuals (children or adults) who acquire good informal knowledge could easily be successful

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<sup>22</sup>John Field, *Social Capital* (2<sup>nd</sup> edition, Routledge, 2008) 34

<sup>23</sup> Ibid 49

<sup>24</sup> Ibid 55

<sup>25</sup> Ibid 49

<sup>26</sup> Ibid 50

in her formal learning and the vice versa. After all, education is nothing more than the process of acquiring skill and information. Human relations are sources of informal knowledge. Traditional communities have been transferring knowledge in the informal way. Therefore, networks provide individuals with the opportunity to get information and hence enhance learning.

## **B. Economic Performance**

Trust is a key economic factor.<sup>27</sup> Trust is crucial element of economic development because widespread distrust in society imposes a kind of tax on all forms of economic activities a tax that high trust societies do not have to pay.<sup>28</sup> Countries with high trust have less cost of production as compared to countries with low trust. Without trust economic transactions would get complicated.<sup>29</sup> The late Prime Minister of Ethiopia, Meles Zenawi, emphasized the importance of trust in the economy as follows:<sup>30</sup>

*“Imagine, everyone having to take everyone else to court in order to enforce a contract. Even if it were possible to completely specify a contract and verify exactly whether it has been fulfilled, it would be very expensive and time consuming to go to court in order to enforce every contract. Where a credit culture that ensures that loans are generally repaid is lacking, very high uncertainty about loan repayment would inhibit extensive economic interaction.”*

Contract is the basis of economic transaction. Human language is incapable of completely specifying the content of contracts. As a result contract interpretation depends on “good faith having regard to the loyalty and confidence which should exist between the parties according to business practice.”<sup>31</sup> Trust reduces transaction costs.<sup>32</sup>

In addition to the macro level, trust could also gives benefits at the micro and intermediate levels. Research has indicated that many workers find their job through

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<sup>27</sup>Munir Quddus, Michael Goldsby and Mahmud Farooque, ‘Trust: the Social Virtues and the Creation of Prosperity’ Book in Review ’(2000) 26(1) Eastern Economic Journal 88

<sup>28</sup>James Ogilvy, ‘Trust: the Social Virtues and the Creation of Prosperity: Books in Review’ (2000) Harvard Business Review November-December 47

<sup>29</sup>Trust in the judicial system is also indispensable and see further discussion infra page 11

<sup>30</sup>Meles Zenawi, ‘States and Market: Neoliberal Limitations and the Case for a Developmental State Good Growth and Governance in Africa; Rethinking Development Strategies’(2011) The Initiative for Policy Dialogue Series 146

<sup>31</sup>See the Ethiopian Civil Code of 1960, Art 1732 and also 1713

<sup>32</sup>Field (n 22)92

personal contacts.<sup>33</sup> This is true particularly when there is high unemployment. This is because employment through connection would enable the employer to reduce the uncertainty about the qualification, ability, and trustworthiness of the employee. Moreover, cost of employment would be kept to the minimum especially for small firms both by demanding no or very low vacancy advertisement cost and employment procedures and by keeping turnover to a low level.<sup>34</sup> “Networks have long been seen as important to business success.”<sup>35</sup>

### **C. Health Improvement**

According to Emile Durkheim, one of the pioneers in development of modern sociology, suicide rate is high in a society where there are low social network and common norms.<sup>36</sup> Moreover, research has shown that people with strong social networks have lower mortality rates than those with weak social ties.<sup>37</sup> People with more social capital are likely to live longer and suffer from fewer health disorders.<sup>38</sup> This is because social networks can furnish tangible material assistance that reduces financial stress.<sup>39</sup> Moreover, networks can reinforce healthy norms which would distance individuals from consumption of narcotic drugs which negatively affect health.<sup>40</sup> Networks also enable friendship and affections which can be resorted to in times of distress. A well-networked citizen can better lobby for medical service by the government, philanthropists or in the community itself.<sup>41</sup> There are also medical evidences that show that interaction with people stimulates body’s immune system.<sup>42</sup>

### **D. Reducing Crime**

“One of the pernicious consequences of declining social capital in the United States, according to Putnam, is increased crime.”<sup>43</sup> Disorganized communities are characterized by high rates of

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<sup>33</sup> Ibid 56-63

<sup>34</sup> Ladebo (n 1) 425

<sup>35</sup> Field (n 22) 59

<sup>36</sup> Barclay Johnson, ‘Durkheim's One Cause of Suicide’ (1965) 30(6) American Sociological Review 883

<sup>37</sup> Field (n 22) 63

<sup>38</sup> Ibid 64

<sup>39</sup> Ibid

<sup>40</sup> Ibid

<sup>41</sup> Ibid

<sup>42</sup> Ibid

<sup>43</sup> Baumer Messner and Rosenfeld, ‘Dimensions of Social Capital and Rates of Criminal Homicide’ (2004) 69(6) American Sociological Review 884



economic deprivation, residential instability, and population heterogeneity which impede the development of both primary and secondary social networks among residents and between communities, which in turn reduces a community's capacity to exert social control, especially over the behavior of youth.<sup>44</sup> Social networks form the infrastructure of social capital which allows for "the reinforcement of positive standards for youth, offering them access to mentors, role models, educational sponsors, and job contacts outside the neighborhood and providing emotional and financial support for individuals, and supplying political leverage and volunteers for community institutions."<sup>45</sup> Severed networks and depleted social capital, in contrast, leave kids to their own devices, increasing the chances that they will act on short-sighted or self-destructive impulses.<sup>46</sup> In addition, destructive forms of bonding social capital, such as youth gangs, may emerge in response to the general depletion of other forms of bonding and bridging social capital.<sup>47</sup>

#### **E. Serving as a Basis for the Rule of Law**

In our discussion here, the definition of the rule of law is "the subjection of human conduct to the governance of legal norms through the operations of a legal system."<sup>48</sup> Legal norm (law) and legal system are main elements of this definition. We limit ourselves to the eight qualities of law: generality, certainty, consistency, clarity, prospective effect, publicity, plausibility and operativity.<sup>49</sup> A legal system is at least a synergy of legal norms, standards, legal policies, legal structures, legal tradition, and legal actors in a given geographical area.

Now imagine rule of law in a situation where it is impossible to trust the legal actors? Is it possible? Unless the legal actors (judges, advocates, public prosecutors, police, law professors, witness, legislator, executive etc) are trustworthy it is simply rhetoric to take of rule of law. If there is no trustworthiness a legislator may have apparent objective which is good and hidden objectives which is evil. This affects at least the certainty and even plausibility of the law.

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<sup>44</sup> Ibid

<sup>45</sup> Ibid

<sup>46</sup> Ibid

<sup>47</sup> Ibid

<sup>48</sup> Matthew Kramer, 'On the Moral Status of the Rule of Law' (2004) 63(1) The Cambridge Law Journal 65

<sup>49</sup> Ibid

For example, some legal professionals describe some of the laws of Ethiopia such as Tax Law, Anti-Terrorism Law and Land Law as Wooden Horse of Troy. Apparently the Tax law intends to increase the revenue of the country which is acceptable to a reasonable person. The Anti-terrorism law is apparently intending to fight terrorism, which is still acceptable to everybody except the terrorists. However, the legislator might have hidden agenda of enabling the executive to weaken and finally destroy its opponents. This conspiracy would be more threatening in parliamentary form of government where the legislator and executive have common ground. The untrustworthy executive may discriminatorily enforce the legal norms and may give apparently reasonable justifications such as lack of enforcement capacity. The judicial institution could also be used as an instrument to facilitate the hidden agenda. In addition to this group interest, individual interest of the parliamentarians and members of the executive may take center stage in the law-making and enforcement.<sup>50</sup>

It is very difficult, if not impossible, for the public to control such institutionalized untrustworthiness because such systems would create a situation where cooperation and networking could fail because of lack of trust among the citizens. This means what is being enforced is not the legal norm agreed upon through democratic process rather the whim and the will of the legislator and executive as institution or individual members of these institutions. This is rule of man not rule of law. If members of the lawmakers or executive are untrustworthy, legal norms hold little value.

Such hollowness of the legal norms would further affect the smooth maturation of constitutional system. Every citizen would believe that the only way to ensure rights is controlling political power or at least be affiliated with those on power. There would be no respect for the law. Moreover, political compromise would be impossible because compromise exists only if there is a trust that parties to the compromise would faithfully adhere to the contents of the compromise.<sup>51</sup> This might have been the main reason why constitutional system is at a very early stage in Africa and conflict has ever been ravaging the continent.

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<sup>50</sup> For political corruption in Africa see Dele Olowu, 'Bureaucratic Morality in Africa' (1988) 9(3) International Political Science Review 215-229

<sup>51</sup> Researches indicate that there is high tendency among the blacks to believe in conspiracy theory. See Ted Goertzel, 'Belief in Conspiracy theories'(1994) 15(4) Political Psychology 731

The trustworthiness of judges, law practitioner, public prosecutor, police, and witnesses are also necessary requirements for the rule of law.<sup>52</sup> The qualification of these legal actors and the availability of necessary physical infrastructures may contribute to the rule of law but these matters are mere rhetoric, if not dangerous, without moral integrity. Imagine a judge who tampers with court records; an advocate who conspires with opponents; a public prosecutor, advocate and police who cook up evidences and imagine a witness who is smart enough to tell lies. It is quite difficult to control these happenings through formal state machinery.<sup>53</sup> The rule of law presupposes that at least the majority of those who are subject to the law are trustworthy.

The rule of law is the only feasible option that the contemporary individual could rely upon for survival. In the past, the individual had relied on religion<sup>54</sup> to be sure that his rights would be respected by fellow individuals and the state. Religion ensures security in two levels. First, in the individual level where the individual believes that the super nature protects him from evil, and second, in the state level where the rulers were accountable to the super nature. As a result of this accountability kings and queens were considered fountains of justice and anybody who was unsatisfied with the laws, decisions and interpretations was entitled to appeal to religious fathers.<sup>55</sup> But now that religion is declining, the state and religion are separate. In a situation where there is no religious solution, the rule of Law remains the ultimate solution.

### 9.3 Bases of trust and its contraction

Despite its multifaceted importance trust has been contracting. Since the bases of trust are religion, morality and community life, it is the shrinking of these bases that has led to the contraction of trust. This subtopic shows how religion, morality and community serve as the bases of trust and the causes of their shrinking.

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<sup>52</sup>Bayard Catron and Michael Harmon, 'Action Theory in Practice: Toward Theory without Conspiracy' (1981)41(5) Public Administration Review535-541

<sup>53</sup> Untrustworthy lawyers could also advice their clients to resort to procedural abuses to harass or even to get financial benefits. See for example Stieglitz's analysis of procedural abuse in intellectual property. Joseph Stiglitz, *The price of Inequality* (Penguin, 2013) 533-535. Apparent bankruptcy is also a usual untrustworthy tactic that lawyers advise their clients to avoid legal debt payment.

<sup>54</sup>Religion/ belief could at least give psychological relief which is really essential for peace and happy life. For example see Ziyad Marar. *Deception (The Art of Living)* (Routledge, 2008) 8

<sup>55</sup> For example the equity in the English Legal System which was enforced by the King's Chancellor.

## A. Bases of Trust

We said that trust is a foundation of human relations. It solders individuals together. It is the glue. But where does it come from? Why the trustor does trust the target and why does the target becomes trustworthy?<sup>56</sup> We can possibly get answers by referring to religion, morality and community norms. They are usually mutually inclusive; religion influences the success of morality and community norms; morality affects community norms and vice versa. However, the three could also stand alone without religion, there may be morality and community norms, and without morality, there would be community norm and visa versa.

### *Religion*

Religion is one of the major sources of trust.<sup>57</sup> Religious people believe that the supernatural power punishes untrustworthy people. They behave trustworthily because they believe that such behaviour would be rewarded both in this world and after death. They also believe, in addition to the reward, there is also a punishment for untrustworthy behaviors both in this world and life after death. The believers trust others because; in addition to recognizing that others would behave trustworthily out of expectation of reward and punishment of the supernatural force they believe that the supernatural force safeguards them against untrustworthy individuals.<sup>58</sup>

### *Morality*

Not all people are religious. Moreover, it does not mean that such atheist individuals are necessarily untrusting person or untrustworthy persons. Although there has been disagreement on sources and contents of morality, there has been a general consensus that human being is a moral animal.<sup>59</sup> Human being has been understood as a creature capable of moral values.<sup>60</sup> Human beings are endowed of mental conscience that defines right and wrong and rewards and punishes accordingly. Thus moral nature of human being can be the basis to trust and to be trusted.

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<sup>56</sup> Trust does not necessary mean that the target is actually trustworthy, it simply indicate the tractor's belief of trustworthiness of the target.

<sup>57</sup>Froster(n 13)

<sup>58</sup> However; this does not mean that believers act foolishly. They rely on the supernatural power only for matters that are impossible or too difficult to verify by their own reasonable efforts.

<sup>59</sup>Peter Bertocci, 'A Reinterpretation of Moral Obligation'(1945) 6(2) Philosophy and Phenomenological Research, 271

<sup>60</sup> Rawls (n 16) 18

### *Community Life*

The fact that contents of morality is the result of either reasoning or human relation and the existence of moral skepticism of individuals make community life a source of trust.<sup>61</sup> Rationalists believe that although morality and its content is innate in human nature not all individuals are capable of discerning it.<sup>62</sup> Therefore, those who are unable to discern morality need someone who does it for them. For example, the early rationalist Plato classify individual into three groups, the rational group, the bravery and the producers; the rational group is the one that discerns contents of morality to the other two groups. Those who believe that the content of morality is the result of social life obviously presuppose community life. Moreover, the fact that some do not believe in morality necessitates community life that could control these skeptics or else they may be nuisance to human relation- individuals must join hands to control these irritants.

Community institutionalizes norms such as trust since it develops and enforces them.<sup>63</sup> Through socialization the youngsters learn these norms. Through social reward and punishment the adults learn to adhere and respect the norms. Through frequent interaction any given social group, large community, or even entire society can achieve norm of widespread and transitive trust and trustworthiness among individuals who have no prior personal acquaintance with each other when they interact.<sup>64</sup> Community life is therefore, the place where a person learns trusting others and trustworthiness by actually living the life. Such practical life enables members not only knowing but also internalizing the norms. Once the norms are internalized the individual members act in accordance of these norms even if there may not be social reward or punishment.

A community may use different methods to make the individual members internalize the norms. The traditional community has been appealing to religion and beliefs. The community teaches that its norms are the ordinance of the supernatural power and violating such ordinance is tangling with not only the community but also the supernatural power. The modern community

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<sup>61</sup>Sheptulin (n 12) 451. Some also believe that morality is a combination of reasoning and human relations. Robert Hinde, 'Robert Law and the Sources of Morality: Philosophical Transactions' (2004)359(1451) Biological Sciences 1685

<sup>62</sup>This depends on theory of knowledge. Rationalists believe that knowledge is innate and revealed through reasoning whereas empiricists believe that knowledge is gained through sensational experience.

<sup>63</sup>Field (n 22) 158

<sup>64</sup>Simon Szreter, 'The State of Social Capital: Bringing Back in Power Politics, and History' (2002) 31(5) Theory and Society 574

could appeal to reason. This may be persuading an individual that adhering to moral values is the issue of individual survival or at least betterment. This is egoistic morality. The community may also appeal to the definition of human being. This is to define human being as an animal that obey certain moral rules. By this definition to be considered as human it is not enough to have intelligent brain and is biped.<sup>65</sup> This is an appeal to the psychological desire of human being to glorify herself. Community may also appeal to altruism.

## **B. Declining of Trust**

Trust has been declining. For example the research of Robert Putnam, the prominent American social scientist in the area of social capital, has indicated that there has been a significant decline in the level of trust in the USA.<sup>66</sup> The decline has been a matter of commonsense in Ethiopia, it is what we experience in our everyday life. Religion, morality and social relations have been declining.

### *Declining of religion*

It is the obvious fact that religion has been declining since sixteenth century. Religious sectarianism, scientism and dialectical materialism have been the major factors for its decline. In earlier days religion was the business of a political entity, the state. But the emergence of sectarianism after sixteenth century led to the emergence of separation of state and religion. In addition to taking religion out from state business, sectarianism has also greatly contributed to proliferation of atheism. Scientific discoveries have also led many to the belief that science is the reliable source of knowledge.

However, more serious and direct attack on religion came from Marx's dialectical materialism. Marxists have vigorously propagated that religion was the result of two spontaneous forces.<sup>67</sup> The first force was the natural force. The low level of development of science made human beings helpless in their struggle against the spontaneous force of nature and this forced them to find a psychological safe harbor.<sup>68</sup> The second spontaneous force was the social force emerged

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<sup>65</sup> Field (n 22) 110 and 114

<sup>66</sup> Sheptulin (n 12) 471

<sup>67</sup> Ibid

<sup>68</sup> Ibid

due to the emergence of propertied class that alienated human being from its labour.<sup>69</sup> This second force makes religion an instrument of exploitation, by the propertied class, the labour of the working mass.<sup>70</sup> Marxists have concluded that these two forces have limited man's freedom and man has to free himself from these forces. Science would redeem him from spontaneous natural forces and communism would redeem him from the spontaneous social forces. If redeemed from such forces he would automatically be redeemed from religious limitations. This propaganda has deeply affected hundreds of millions of people.<sup>71</sup>

### *Declining of Morality*

Morality has also been declining. The major causes for declining of morality are scientism and social disorganization. Although moral skepticism has existed for long, the emergence of science has clouded objective morality. Moral values are not measureable by using scientific measurement units. This has opened the room to refute moral judgments as subjective/relative. The disintegration of rural community due to industrial revolution also reduced the incubation place of objective norms. Religious decline and Marxist's dismantling of earlier moral values also contributed to the declining of morality. Although Marxists were able to destroy many of the earlier moral values, they were not able to develop substitute moral values. Rescuing morality from collapse into subjectivity appears difficult.

### *Declining of Community*

By the word 'community' we mean the solidarity created by the interaction of peoples of the same residence without any formal express prior agreement.<sup>72</sup> Most traditional communities have been formed either on the basis of ethnicity or religion or both. It is a common sense that traditional communities have been decaying since the industrial revolution. The French Sociologist Emile Durkheim realized its negative consequence and proposed professional associations as a substitute.<sup>73</sup>

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<sup>70</sup> Ibid 472

<sup>71</sup> Peter Singer, *Marx: A Very Short Introduction* (Oxford Paperbacks, 1980) 1

<sup>72</sup> Wilson Majee and Ann Hoyt, 'Cooperatives and Community Development: A Perspective on the use of Cooperatives in Development' (2011) *Journal of Community Practice* 48

<sup>73</sup> Charles Marske, 'Charles Durkheim's "Cult of the Individual" and the Moral Reconstitution of Society' (1987) 5(1) *Sociological Theory* 4

However, as Durkheim himself recognized, professional associations have not been able to substitute the traditional community.<sup>74</sup> Humanity is not only rational but also emotional. It is very difficult for formal associations to satisfy the emotional part of humanity. Even such formal associations have been declining in recent times especially in areas where political liberalism has taken root. For example, Robert Putnam's research indicated that social connections have been declining in the United States.<sup>75</sup> The dominance of communitarian ideology approximately from 1880s to 1980s might have contributed to reinforce associations and its decline since 1990s might implicate the declining of formal association.<sup>76</sup>

Beyond ideological changes there have been concrete factors that contributed to the declining of community life. Robert Putnam classifies such factors into contributory and major factors.<sup>77</sup> Contributory factors are sheer busyness especially due to the movement of women into labour force whereby families do not have enough time to participate in community life and 'social mobility.'<sup>78</sup> He doubts the urban mobility because his research indicated that despite increased home ownership civic participation has still been on the decline.<sup>79</sup> The main two factors are demographic transformation and technological transformation of leisure.<sup>80</sup> Demographic factors include fewer marriages, more divorce, fewer children and lower real wage.<sup>81</sup> Married, middle class parents are generally more socially involved than other peoples.<sup>82</sup> Larger economic phenomenon such as decreased local markets and increased mega and online stores has exacerbated the demographic factors.<sup>83</sup> For Putnam television is the major technological factor that affects community participation since TV watching takes time that

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<sup>74</sup> Ibid See also James Kerri, 'Nwannukwu Studying Voluntary Associations as Adaptive Mechanisms: A Review of Anthropological Perspectives [and Comments and Reply]' (1976) 17(1) *Current Anthropology* 23-47

<sup>75</sup> Field (n 22) 110

<sup>76</sup> Ibid 125-130

<sup>77</sup> Ibid 39

<sup>78</sup> Ibid

<sup>79</sup> Robert Putnam, 'Bowling Alone: America's Declining Social Capital' (1995) 6(1) *Journal of Democracy* 65-78

<sup>80</sup> Ibid

<sup>81</sup> Ibid

<sup>82</sup> Ibid

<sup>83</sup> Ibid



might be used for socializing and it keeps people in their home.<sup>84</sup> TV also encourages passivity and may even tend to create anti-civic tendencies<sup>85</sup> such as destroying the existing community.

However, Putnam's analysis does not seem to refer to the traditional community, he seems to be referring mainly to associations speculated by Durkheim. The major reason why traditional communities have been declining is the rapid urbanization following the industrial revolution. In fact, Western countries have almost completed their urbanization process and have reached the stage of organized urban life. But African countries, particularly Ethiopia, have been on the process of transition from agrarian society to an urban population. As a result of this urbanization, the rural community is disintegrating. The urban area is also socially disintegrated since the settlers are new comers who have not been well accustomed to this new life and hence unable to organize a meaningful community. The urban redevelopment policy of the government which displaces old settlers in the center of the towns particularly in Addis Ababa has been an additional challenge to settled life in urban areas.<sup>86</sup>

Moreover, Putnam's claim that urban mobility is of no significant contribution in the declining of community life does not seem to be true at least for Ethiopia. Firstly, although there is no research in the area, my own personal observation in Hawassa and Addis Ababa indicates that as soon as a person becomes an owner of a residential house, which means permanent residence, his immediate action is to join the local '*Edir*,' a community that carries out burial ceremony. He also immediately becomes a member of a nearby church or mosque so that he would get access to the local morgue. Residential house ownership contributes greatly towards community life.

The other defect of Putnam is his failure to analyze the declining of power of communities. If the community becomes of no value there is no valid reason for individuals to join the community. Through time communities have lost all their traditional authority over individual residents and have become empty. In the past communities used to control local dealers. This was because business was mainly in the form of bartering mainly between non-trader local communities.

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<sup>84</sup> Field (n 22) 115

<sup>85</sup> Ibid

<sup>86</sup> Most of the houses in Addis Ababa are mud-plastered very old wooden shacks constructed without plan and internal infrastructure and the government has been replacing some of them with condo houses.

Even in the case of cash transactions the traders are individual retailers who were members of the community. Thus transaction carried out in the local community was used to be governed not only by formal commercial law but also the custom of the community. The community had the informal authority to reward or punish parties to the transaction because they were members of the community.

But now a days bartering has already died out and retail traders are mostly alien to the community. This means any resident who has been offended by the retail trader never gets any remedy from the community since the trader is outside of the informal jurisdiction of the community. The proliferation of companies in the local trade further exacerbates the challenge since companies would serve to curtail and hide the individual responsible; community punishment is usually more effective on individuals than companies. Furthermore, since companies are usually stronger than the community they may even lobby directly or indirectly against customary values of the community and may even work hard to destroy the community.<sup>87</sup> Putnam recognized the contribution of the decrease of local markets and the increase of mega and online stores to the declining of community<sup>88</sup> but he seems to relate it to the declining of interaction between residents. This is in fact right but it is only one side of the problem, he does not emphasize the community's inability to control what is going on.

In addition to commercial transactions, the community has also lost control over the civil relations of individuals living in the community. For example, marriage in the past was mainly a community matter. Families and the community had a great role in the choice of spouses, on conditions of marriage, the wedding ceremony and even in the determination of rights and duties of the spouses during the continuation and dissolution of the marriage. But all these powers have already been transferred to the formal law and court. The criminal and civil jurisdiction of the society has already gone to the state. Generally the customary laws have been completely abolished. And, even after being abolished, incessant attacks have been carried against them both by the state and other modern institutions, so that they would lose not only the legal basis but also the moral basis to which they may appeal to control individual residents.

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<sup>87</sup> Putnam also sees that TVs may work to destroy community. This implies that companies may use media to destroy community. See Field (n 22) 115

<sup>88</sup> See our discussion on page 18

The community also lost its power to educate its young generation. In the past education was mainly given by the local community in the informal or formal way but now this has become the responsibility of a state. This denies the community any chance to educate according to its customary laws and moral values and to pass these on to its young generation. Even more the state and private run formal education serves as additional instrument to totally discard customary norms.<sup>89</sup>

What worries us is not the decaying of customary norms but the inability of the modern system to substitute them. In Africa in general, and in Ethiopia in particular, modern laws and the State have not been able to substitute for customary norms. The State has serious difficulties in enforcing laws and prosecuting either due to infrastructure problem or because of lack of trust. The State has also shown glaring weakness in producing, through its modern education, trusting and trustworthy citizens. As such communities should be revived to complement and solve some of these defects. Communities remain the best place to produce trust.

## **9.4 Conclusion**

This Chapter shows that lack of trust is a social problem that needs to be addressed. Without trust human relation and civilization is unimaginable. Moreover; trust improves educational performance of children, increases economic efficiency at all levels, improve individual's health, reduce crime rate, and ensure rule of law. However; trust has been declining due to the declining of religion, objective morality and traditional community. The revival of community would possibly lead to the revival of trust.

The next Chapter shows how the community could be revived through cooperatives.

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<sup>89</sup> Communists were using everything possible including education and cooperative to discard the preexisting norms of all types.

# **CHAPTER TEN**

## **REBUILDING COMMUNITY THROUGH COOPERATIVES**

### **10.0 Introduction**

In the previous Chapter, we have seen that trust is declining due to the decline in religion, morality and community. It has been suggested that to salvage trust, we need to do something to stop, or at least to reduce, the decline of religion, morality and community. The primary way this can be achieved is to revive community life. Cooperatives could serve as the best means of reviving community. In this chapter, we show that because of the nature of cooperatives, they can be utilized to reshape community in-line with traditional community values.

This Chapter is divided into six sub-topics. The first subtopic indicates the urgency of building community in Ethiopia. The second subtopic shows that consumer cooperatives resemble traditional community. Cooperatives are relatively unoccupied localized association capable of creating strong interaction between residents and originally also designed to create community of 'New Moral World.' The third subtopic shows that cooperatives would be attractive to individual residents. The fourth subtopic shows that cooperatives could have a community resembled management structure where democratically elected elders are the leaders. The fifth subtopic shows that in addition to rebuilding trust at the local level, cooperatives could promote trust between communities and serve as a forum for crime prevention, a source of information and a method of preserving culture. The final subtopic argues that the state, charities and manufactures should limit their involvement with cooperatives as far as possible; with the possible exception of delegating powers and providing financial aid.

Aside from being relatively unoccupied, cooperatives, especially consumer cooperatives, display a tendency to strengthen the interaction between individuals. This is because they have a common supplier amongst other factors. They could also be used to alter the behaviour of resident retail traders and increase their bargaining power against national and transnational

companies. Residents in the locality become members of the consumer cooperatives in order to benefit from the supply of goods/services of the cooperatives and other benefits.

Elderly community members are better suited to manage the cooperatives because they are able to commit the time needed for the role and have extensive knowledge of local cultures. The cooperatives may also directly or indirectly promote the solidarity of the villagers through cooperative meetings, creational centers and ceremonies. These combined incidents would finally create a strong community that exercises informal control over the residents. The Government, NGOs and manufacturers could also help cooperatives to build a stronger community.

### **10.1 The special urgency to rebuild community in Ethiopia**

Although rebuilding trust by reviving the traditional community through the use of cooperatives is necessary, such a task is also urgent for Ethiopia. This is because Ethiopian society is in transition. There are five major factors that make the Ethiopian situation urgent and unique; the extent of flux in the community, limited state capacity, constitutional issues, the democratization process and the immature media.

Firstly, Ethiopian communities are unstable. Ethiopian society is comprised of hunters, pastoral nomads, sedentary agriculturalists and urban dwellers. All these communities are on the process of transition. The Government has already started resettling the hunters and the pastoral nomads into sedentary agriculture. Urbanization in Ethiopia has been a very recent history and less than twenty percent of the population is residing in urban areas. As a result there is rapid migration from hunting, pastoral nomads and a sedentary community to urban communities; Ethiopia is in the process of urbanizing its population. The modern economic situation pushes for urbanization. Moreover, since urban communities are a recent phenomenon in Ethiopia, the communities have not yet reached the strength expected of them. Furthermore, the Government's urban redevelopment policy of replacing mud-plastered wooden shacks particularly in Addis Ababa has been dismantling the urban community that might have been formed had the redevelopment not gone ahead. In short communities in Ethiopia are in a constant flux. This means that the traditional community has been disintegrating without any immediate reinforcement of the positive principles which the Country would benefit from were they to continue. This is not the

case in the Western world. Western communities are almost entirely urban communities with less migration to urban areas. Moreover, since urbanization has been a long history in the West, the urban community has already been relatively solidified. There is also no massive urban redevelopment.

The second factor that makes the case of Ethiopia urgent when compared to the West, is the limited capacity of the state to enforce formal laws. Ethiopia contains around ninety-five million people and is considered the second poorest country in the world. This means the country does not have enough resources to properly organize state structures and to enforce laws to the expected standard. Modern technologies and expertise especially in criminal investigations are also lacking. So Ethiopia cannot confidently rely on modern laws, as the state has to delegate some of its duties to the local community and to trustworthy individuals. The West is capable of organizing the state machinery to the expected standard.

The third unique part of Ethiopia is the simultaneous constitutional recognition of the rights of nations, nationalities and the freedom of residence:

*“Every Nation, Nationality and People in Ethiopia has the right to speak, to write and to develop its own language; to express, to develop and to promote its culture; and to preserve its history.”<sup>1</sup>*

Similarly every Ethiopian citizen has the freedom to choose his residence and reside without Government restriction.<sup>2</sup> Unless a solution is designed, these two rights could possibly conflict and could even lead to political instability.<sup>3</sup> Immigration has the potential to change and develop the local language and culture, but this means in turn that the local language and culture is a risk of being superseded by new ideas brought by immigrants. This happens because the local community is not solid enough to neutralize the influence the new comers and then put them under the influence of the local language and culture. Cooperatives would solidify the local community.

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<sup>1</sup> Federal Democratic Republic of Ethiopia Constitution, Art 39(2)

<sup>2</sup> Art 32

<sup>3</sup> The case of Amhara settlers in Guraferda of SNNP, Benishangul-Gumuz and Western Oromia was a hot political issue in 2011, 2012 and 2013. Although land was an apparent issue the real fear has been the possibility of the dominance of Amhara language in the areas.

The fourth issue that makes community solidarity through cooperatives very urgent is the democratization process. Ethiopia has not yet shown significant improvement in her political democratization process. This may be related to the social consciousness of the people. Therefore, community solidified through the cooperatives may serve as a forum of inculcating democratic ideas from the local and grass root level. The community may also serve as an apprentice for future leaders to learn and practice democracy.<sup>4</sup>

The fifth issue is the immaturity of the media in Ethiopia. The media is considered as the fourth government in western world. Media provides information thereby enabling individual to exercises the rights to get sufficient information about his surroundings and village he is living in. This is creating networking between individuals both to help and control each other. The media provides a forum for public gossiping or twitting about peoples living in their community thereby shaping behavior through naming and shaming. For example, the British people have practically been able to control the behaviour of their celebrities through naming and shaming. However, such a modern source of information is inadequate in Ethiopia. So until such time that the media could be available adequately we should stick to the traditional way of information communication that is personal and oral communication. Community is the best place for such purposes.

## **10.2 Cooperatives replicate traditional community**

Consumer cooperatives could be a modern replica of traditional community since it was designed in the beginning to build a community of “New Moral World,” and as such it is generally an association of residents of the same locality and it is a forum for individual interactions.

### **A. Community of New Moral World**

Robert Owen who began the modern cooperative movement in Britain in the first half of nineteenth century designed cooperatives to be a community that produced citizens of good

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<sup>4</sup>Stanley Renshon, ‘Political Leadership as Social Capital: Governing in a Divided National Culture’ (2000) 21(1) Political Psychology; 199-226

character.<sup>5</sup>He intended the village of cooperatives to replace the old, immoral, competitive world with the “New Moral World.”<sup>6</sup>This idea was taken over by the two successive phases of the British cooperative movement-Owenite communities and the Rochdale Society of Equitable Pioneers.<sup>7</sup> The history of the Israeli cooperative movement also indicates that the primary target of the cooperative movement was formation of strong Jewish community in the Middle East.<sup>8</sup> Cooperatives were also formed in North America for the purpose of building a community of new settlers. In Africa also, the French and the Belgians’ were using cooperatives to build local communities that could serve as a basis to develop and disseminate the colonialists’ culture. There is also a recent interpretation that Emile Durkheim’s social solidarity would best be realized through cooperatives.<sup>9</sup> Cooperatives have been an essential aspect of social integration in the peasant communities of East Asia.<sup>10</sup> Recent community development researches also indicate the relevance of cooperatives to build community.<sup>11</sup> A research made in Italy in 2010 also shows that cooperatives would be utilized to dismantle parochialism and clientelism which are the major challenges to community development in Italy.<sup>12</sup> In short, cooperatives have been used to build a community.

## **B. Localized**

One of the major characteristics that distinguish cooperatives from investor owned firms is the restriction of membership to local residents. True cooperatives are associations of individuals where as investor owned firms are associations of capital. Cooperatives are alternative market either for goods and services (producer or consumer cooperatives) or labour (worker cooperatives).The accessibility issue of such a market makes cooperatives associations of

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<sup>5</sup>Arnold Bonner, *British Cooperation The History, Principle and Organization of the British Cooperative Movement*(Co-operative Union Ltd, 1961) 10

<sup>6</sup> Ibid

<sup>7</sup> Ibid 46

<sup>8</sup>Margarett Digby, *Cooperatives Land Use: The challenges to traditional cooperation* (1<sup>st</sup> edition, Basil Blackwell, 1965) 34

<sup>9</sup> Lawrence Black and Nicole Robertson, *Consumerism and the Cooperative Movement in Modern British History: Taking Stock* (Manchester University Press, 2009) 86-100

<sup>10</sup> William Lebra, and Thomas Maretzki, *The Community Cooperative in Northern Okinawa Economic Development and Cultural Change* (1963) 11(3) Part 1 Economic Development and Cultural Change 225-238

<sup>11</sup>Wilson Majee and Ann Hoyt, ‘Cooperatives and Community Development: A Perspective on the Use of Cooperatives in Development’ (2011) 19 *Journal of Community*

*Practice*<<http://dx.doi.org/10.1080/10705422.2011.550260>> accessed 10 June2011 48-61

<sup>12</sup>Vanna Gonzales, ‘A different kind of social enterprise: social cooperatives and the development of civic capital in Italy’ (2010)41(1) *Community Development* 50–75



residents of the same locality. Transporting goods and service has significant costs but capital can easily move from place to place with low costs of movement. In short, cooperatives are equivalent to traditional markets where the purchasers and the sellers are the local community members.

The idea of community in the New Moral World idea, as discussed in the preceding subtopic, also implies that cooperatives are local associations. The Rochdale Society of Equitable Pioneers, which has been a model of many modern cooperatives in all corners of the world, was also established by residents of the same locality. In congruence with this character of cooperatives, the Ethiopian Cooperatives Law also provides that cooperatives shall be established by persons who live or work in a given area; shares could be sold outside of the locality of the cooperatives only if the cooperative is in dire need of capital.<sup>13</sup> So this localized nature of cooperatives makes it feasible for cooperatives to become the modern replica of traditional community.<sup>14</sup>

### **C. Currently unoccupied**

Compared to a state, the traditional community has been usually occupied with very limited responsibility and has had sufficient time of strengthening the relationship between the residents of the community and protecting and enforcing the norms developed in the community. A state is burdened with a lot of duties such as law making, enforcing, adjudicating, defence, development, and fighting terrorism. Similarly compared to states, cooperatives are currently remaining idle, since their historical role has been fully or partly taken over by the state.

Historically, cooperatives emerged as a solution to economic and social problems left unaddressed by the states such as trade monopolies, consumer rights and exploitation. After the second half the nineteenth century antitrust laws have been issued in many countries and state has taken responsibility to control monopoly. Consumer protection laws have been issued at least

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<sup>13</sup> Ethiopian Cooperatives Law, Art 6(2) cum art 16(6) as amended.

<sup>14</sup> However; some saving and credit cooperatives may be far from replicating traditional community since there members may be people working for the same employer. Even then they are localized associations although the locality is not residential locality. This type of saving and credit cooperatives is the dominant features of cooperatives in Ethiopia. This may imply that Ethiopian traditional communities have been shattering and as a result people have been trying to replace this phenomenon by association in the work place which is relatively stable. For example, this researcher has worked for more than twelve years in for one employer but has resided in more than eight communities showing that residence is more unstable than employment. Saving and credit cooperatives can be established in the residential area, if something is done to revive the traditional community.

after the Second World War. Welfarism has also been pushed into state policy. This situation leaves cooperatives to become redundant and out of place.

Thus, if cooperatives do not get objectives that coincide with their basic ideology, they would either wither away or would serve as a camouflage for rentiers or dictators. The rentiers may put themselves under the gown of cooperatives and demand privileges and support from government welfare. The dictators may also use cooperatives as a means to control the national economy or to create economic discrimination. For example, special privileges recognized under Ethiopian Cooperatives Law are prone to high level of discrimination between citizens.<sup>15</sup> Since the contemporary problem unaddressed by the state is the gradual erosion of trust the cooperatives would be the best candidates to fill this gap. In addition to the lack of necessary conditions for building trust, the contemporary government is overburdened with security and economic issues at the macro level. Cooperatives have now enough time to take the responsibility of rebuilding community.

#### **D. Forum for individuals Interaction**

Cooperatives, especially consumer cooperatives, can replicate traditional local market and social gathering since it could serve as a forum to seek, receive and impart information and ideas of all kinds.<sup>16</sup> This makes it the modern replica of traditional community.

##### *Cooperatives as a local market*

In traditional community in Ethiopia, transactions have been mainly achieved through bartering, although now that has been changing rapidly.<sup>17</sup> This means transactions were mainly between local residents. This therefore; increases the chance of interaction between the residents. Even in the case of a transaction which is a cash transaction, the dealer would mostly be local resident. The dealer may even serve as a 'journalist' to the residents since he would bring them

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<sup>15</sup> See our detail discussion under Chapter Three

<sup>16</sup>The Federal Democratic Republic of Ethiopia Constitution, Art 29(2) recognizes freedom of information in all form and from all corners. Since the media is infant in Ethiopian and most of the population in Ethiopia even in urban areas are unable to read and write such freedom could be real to all if the traditional sources of information are made to continue.

<sup>17</sup>This researcher was very much accustomed to bartering which is known as 'liwcha' in Amharic in his birth place, about one-hundred thirty kilometers north of Addis Ababa. There was a specified location in the market for such bartering. Almost all types of agricultural products could be bartered. However, the information this researcher got from the local residents shows that such bartering has already died out.

information about other localities or remote areas. The fact that the dealers are local residents would enable the community to indirectly control even non-resident traders who supply goods to the local dealers. This is because since the local community controls the dealer through his social relations with the community, where he would be forced to properly bargain while purchasing his trading stock. The local drinking houses also serve as a forum for residents to meet each other.

Likewise cooperatives could serve as a transaction between residents. While going to purchase from the common shop there is a higher possibility that they meet each other and share ideas than a purchase made out-of-town. The cooperatives would also serve as a medium to control producers and suppliers of goods traded in the cooperative shop. In addition, the cooperatives may provide recreation centers that could further widen the opportunity of residents to know each other.

### *Social Gatherings*

Traditional communities have social gatherings of different kinds and purposes. For example in Ethiopia there are religious and cultural gatherings. *Mesqel* (Finding of the True Cross)<sup>18</sup>, *Timqet* (Baptism), *Ashendye*, *Erecha*, and *Fiche-Chambellalla* are very well-known gatherings.<sup>19</sup> There are also gathering for economic reasons such as *Equb* (traditional saving& credit) and *Debo* (friendly gathering for any type of work) and social reasons such as marriage and burial ceremony. All these create an opportunity for individual interactions. Cooperatives can imitate traditional communities by providing alternative ways of gatherings such as annual general meetings, marriage and burial ceremonies and other festivals.<sup>20</sup> In short, like traditional communities cooperatives could also be a forum of social gatherings.

### *Intercommunity relationship*

Social scientists classify individuals' relationships in the community level into three: bonding, bridging and linking relationships. Bonding relationship is the interaction between individuals

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<sup>18</sup> The UNESCO registers it as intangible heritage in 2014

<sup>19</sup> These gatherings are normally gatherings at a local level although there seems some shift towards large gathering in case of *Erecha* and *Fiche-Chambellalla*.

<sup>20</sup> However, since modern community is composed of individuals from diverse religion and culture, cooperatives cannot imitate the religious and cultural gatherings

from the same sociological background in a relatively narrow locality.<sup>21</sup> This interaction tends to reinforce the exclusive identities of homogenous group.<sup>22</sup> Local markets and social gatherings are agents of this social bonding in traditional community. Bridging relationship is linking individual members of the community to more distant and broader identities.<sup>23</sup> Linking relationship consists of relationship up and down the social and economic scale.<sup>24</sup> It allows people to leverage resources, ideas and resources, ideas and information from contacts outside of their own social milieu.<sup>25</sup>

The traditional community has been playing roles in bridging relation. The leaders of the community play a role in marriage and disputes between residents of different community. The community could also serve as an address of individuals. Local markets may also attract sellers/purchasers from neighboring communities. Cooperatives could exceed traditional communities in creating bridging relationship. This is because cooperatives could be established at a community level to play bonding role, at intercommunity level to play a bridging role and at a national level to play linking role.<sup>26</sup>

### **10.3 Membership as a rational choice**

In this subtopic, we address two issues; the basis of cooperative membership and the limitation on principle of open membership. It is argued that an individual's rational choice should be the basis of cooperatives and in order to maximize member benefit, the maximum number of members should be limited to the optimal maximum. We first start with the basis and then proceed to principle of open membership.

#### **A. Rational choice as basis of cooperatives**

Cooperative membership is voluntary and open to everybody who needs the services of the cooperative. But why do people join cooperatives? What is the motive to join cooperatives? Is it because of utilitarian moral obligation or out of natural duty or brothers' sake (altruistic sake) or

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<sup>21</sup>John Field, *Social Capital* (Routledge, 2008) 73

<sup>22</sup> *Ibid*

<sup>23</sup> *Ibid*

<sup>24</sup> *Ibid*

<sup>25</sup> *Ibid*

<sup>26</sup> Art 6(2) of Ethiopian Cooperatives Law and Art 3-7 of Council of Ministers Regulation No. 106/2004 to provide for the implementation of the Cooperative Societies Proclamation No.147/1998

own sake? Is it immoral to give priority to one's own interest without regard to the interest of others? In short, to which moral theories should cooperators appeal to persuade individuals to invite them to cooperative membership, if the cooperatives have to attain the objective of building community that nurtures trust?

We are intending to build a community that nurtures moral norms that become the basis of trust. Individuals need to be trusting and reciprocate trustworthiness because it is impossible, or at least difficult, to live without it. Trust is the value required for individual survival. It is individual's choice to trade his own trustworthiness for trustworthiness of others. This means the basis of trust is individuals' rational choice.

The dominant normative theories of morality are deontological, utilitarian, altruism and egoism.<sup>27</sup> Deontological theory claims that a person is said to be moral when he/she fulfils her duties regardless of the consequence thereof.<sup>28</sup> The duties are keeping promise, speak the truth, pay our debts etc.<sup>29</sup> Utilitarian theory claims that all acts which are right are so simply because they will produce the best consequences possible in the circumstances. Altruism declares that any action taken for the benefit of others is moral and any action taken for the benefit of oneself is bad.<sup>30</sup> However, we cannot persuade individuals to join cooperatives by appealing to moral theories because it is the decline of morality that forced us to see for alternative ways of reviving morality.<sup>31</sup> Had morality been practically working we do not need to search for alternative means of preserving and maintaining trust.<sup>32</sup>

Moreover, Deontological theory emphasises a duty is created upon a person after such a promise is entered into. Our primary concern here is how to persuade a person to give his promise. It is believed that if there is reason that persuades a person into an obligation the fear of loss of the thing that pushed him into the obligation could be sufficient means to keep him obeying his promises. Utilitarianism by its nature is far from ensuring trust, because a person may violate

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<sup>27</sup> Oliver Johnson, 'Rightness, Moral Obligation, and Goodness' (1953) 50(20) *The Journal of Philosophy* 597

<sup>28</sup> Ibid

<sup>29</sup> Ibid

<sup>30</sup> Ayn Rand and Nathaniel Branden, *The Virtue of Selfishness: A New Concept of Egoism* (Signet/New American Library 1964) viii

<sup>31</sup> See our discussion of declining of morality in Chapter Eleven

<sup>32</sup> Joseph Mackie, 'Obligations to Obey the Law' (1981), 67(1) *Virginia Law Review* 143-158

trust if such act could produce more happiness or reduce more pain. Although such criticism is usually directed against act utilitarianism, rule utilitarianism never escapes the challenge, since the law maker may change the law now and then based on the consequence thereby killing the trust that should exist between the subjects and the governor. Altruism is of no practical relevance either because very few people are altruists or its equivalent of rational egoism.<sup>33</sup>

Furthermore, the three theories depend on the individual's self-regulation of the actor without giving any room for the victim of the act to take measure on the actor. Thus, in addition to overburdening individuals with duties, these theories create apparently powerful but actually powerless individuals who have very little power to decide on their own fate. They also leave wider room for free riders.

The practicable theory that can justify cooperatives that build community is rational egoism. According to this theory it is moral to act in one's own rational interest. A rational person is prudent and hence can judge what benefits him now and in the future. He is always after maximizing his own benefits. Such person does not bother about the others unless there is something that concerns him. This person's action is called rational action.

Although theory of rational action has been used to justify economic decisions of individuals, it is now used by sociologists to justify social relations.<sup>34</sup> "Individuals normally pursue their own interest; if they choose to cooperate, it is because it is in their interest to do so."<sup>35</sup> This rational action protects the collective interest without affecting individual freedom. Modern community is composed of individuals from diverse background and attitude. Community building should not affect their right to reside in the locality of the cooperatives. Respecting individual rights and

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<sup>33</sup>Ziyad Marar, *Deception (The Art of Living)* (Routledge, 2008) 22-23. One may also argue that Bible itself preaches rational egoism: a person obeys the rules of God if he wants to get reward and escape punishment both in this world and after death. Three examples are enough to show this. Example one: the usually cited Golden Rule "do unto others what you want others do unto you ultimately implies rational egoism, it is a matter of reciprocity. A prudent person not only wants trustworthy persons but also realizes that she can get this only if she herself is trustworthy. Example two: the metaphor of salt in the Luke 14:34-35: "Salt is a good thing; but if salt itself becomes tasteless what will you use to season it? If it is useless either on the land or on the dung-heap; it can only be thrown away." Third example: Jesus returns to recompense and requite everyone according to his deeds. (Revelation 22:12)

<sup>34</sup>Michael Hechter and Satoshi Kanazawa, *Sociological Rational Choice Theory* (1997) 23 Annual Review of Sociology 191-214

<sup>35</sup>Field (n 23)

freedoms would also create friendly atmosphere for the cooperatives; no resident would have an interest to challenge the cooperatives as far as his right is not affected. Moreover, this rational choice would keep unwilling or unconvinced residents out of the membership of the cooperatives. Forcing unwilling or unconvinced people to join cooperatives by any means including morality or law is creating administrative burden on the cooperatives.

Historically also successful cooperatives have been those established on the basis of rational choice theory. Robert Owen's village of cooperatives was mainly the result to altruism but failed. The Owenites community was mainly the result of utilitarianism but also failed. State supported cooperatives in Africa and socialist countries also failed with the failure of government. As we discussed in Chapter seven and eight, Ethiopian cooperatives have already become crippled since the state interferes and imposes a utilitarian doctrine on the cooperatives. But the Rochdale Society of Equitable Pioneers was established on the basis of rational choice of the members and became the basis of British and international cooperative movement. The producer's cooperatives of North America have also been successful and their basis has been rational choice. So cooperators should appeal to benefits that a member gets if he becomes member and opportunities he lose if he is outside of the cooperatives.

#### **B. Limitation on the principle of open membership**

In order to maintain the efficiency of rational choice, there should be maximum limit of membership. It is very difficult to strengthen and solidify the community through cooperatives unless the number of members is manageable. If the number is too big it is difficult to know each other. So principle of open membership should be limited to the optimal maximum by defining locality to a limited territory. However; within the limited territory every body willing to use the cooperative should be given freedom to join the cooperative.

## **10.4 The management of cooperatives**

In this subtopic, we highlight the importance of collective management and elderly membership in the management and then hypothesis the possible adaptation of the traditional community management styles such as ‘Gada System.’

### **A. Collective Management**

Cooperatives should be managed by group of individuals. Only the group decision, both as policy maker and executive, binds the cooperative community. This is to avoid any possible emergence of individual dictators. Individual dictatorship is a virus that eats up the cooperative community. Dictatorship opens a room for parochialism and clientelism. In addition to pushing some members to go out of the cooperative, it opens a room for power competition. The management organ should therefore, be limited to the management board and control committee and other sub-committees subordinate to these two major organs. These organs are accountable to the community’s general meeting.

### **B. Elderly management**

If the cooperatives have to build social solidarity by reviving the traditional community its management has to remain in the hands of elders of the community. This is for two major reasons. The first reason is that the elders have sufficient time to dedicate to the cooperative. Most individuals leave the labour market at the age of sixty either due to the existing pension law or due to less productivity of the labour after such age. For the cooperatives, the availability of experienced individuals and the benefits of community leadership which it can offer makes it an attractive proposition. Moreover, they are usually experts (informal knowledge) in dispute resolution. Furthermore, community management is mainly an appeal to reverential fear and elders are more revered. Therefore, although democratic election is means of coming to the management position, elderly age should be one of the legibility criterions.

### **C. Hypothesizing the ‘Gada’ system**

If we have to revive traditional community, it would be logical to revive the management styles of this traditional community as far as such style is democratic and overlaps with cooperative ideology. Such a style of management would be very important in a situation where the



community is relatively homogenous and conscious of its own culture. But since most traditional communities exclude women from leadership serious measures should be taken to abolish such exclusion.

Gada System was a traditional community leadership at micro, meso and macro level in the south and south central Ethiopia before the formation of modern government. It is a segment of generation that succeed each other every eight years in assuming responsibilities.<sup>36</sup> It is believed to continue to exist in the grass root level although the macro level institutions were decayed.<sup>37</sup> The peculiar feature of this system was that it classified members of the community into groups on the basis of their age and each group had a social duty assigned to it. This grouping contributes a lot in solidifying the community, acculturating and preparing the younger generation for leadership. The other interesting feature of the gada system that makes it candidate for cooperative community in contemporary Ethiopia is its tendency to assimilate new comers into the dominant society. The simultaneous recognition of collective ethnic right to language and culture and the freedom of movement under Ethiopian Constitution may conflict unless there is a system that absorbs the new comers without posing language and cultural clashes.

## **10.5 Major and subsidiary tasks of cooperatives**

The main tasks of cooperatives are serving as an alternative market for the members. As a subsidiary task, the cooperatives may serve as a reference, source of information, crime control, source of informal knowledge and forum for cultural preservation. Both the main tasks and subsidiary tasks serve as glue to solder the residents together. This subtopic indicates the extent of these tasks.

### **A. Alternative market for the members**

Cooperatives are economic organization. Its major task is involving in economic activities. However, the cooperatives that are expected to strengthen the local community it has to serve as

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<sup>36</sup> Asmerom Legesse, *Oromo Democracy: An Indigenous African political System* (Red Sea Press, 2000) 31

<sup>37</sup> Ibid 30

an alternative market of consumption goods/services so that every member of the community could have some interest in the cooperatives. However, the consumer cooperatives should limit themselves to retail shop in the primary level and wholesale in the union level. There should not be any participation in production. This is because such task overburdens the cooperatives and may alienate it from its ultimate task of building community. Due to their cooperative nature (as compared to competitive nature of investor owned firms) and lack of expertise in the management cooperatives could not be efficient in the production. Moreover, involvement in production would exacerbate the conflict of interest between cooperatives and investor owned firms. So cooperatives should specialize in distribution whereas investor owned firms should specialize in production. In addition to consumer goods/services, rural cooperatives may also serve as product market. Consumer cooperatives could also serve as labour market as its major or secondary task.

## **B.      Subsidiary tasks**

In addition to the major economic task, cooperatives may carry out social activities. These activities increase the chance of interaction of the residents of the community and also serve as a justification for state and charity assistance.

### *Reference*

The cooperatives may provide certificate of reference to the individual member resident whenever a testimony about the behaviour of the person is required. This encourages individuals to participate in the cooperatives and disciplines him to behave in accordance of the local norms. It also increases the recognition of the role of the cooperatives by other institutions such as courts and employers.

### *Source of information*

In urban Ethiopia, it seems very difficult for the Government to know some of the residents of a locality. This poses a security danger especially in relation to terrorism. The cooperatives could

follow up the daily activities of new comers and provide necessary information to the government if they appear to be dangerous.<sup>38</sup>

#### *Crime prevention*

In addition to community surveillance and the reporting of suspicious behaviors to the police the community can control crimes through policies that are more closely associated with restorative justice, re-integrative shaming and peacemaking criminology.<sup>39</sup>

#### *Source of informal knowledge transfer*

Cooperatives could also serve as a forum of informal learning both to the youth and the adults. Knowledge is mainly experience sharing. The interaction of the residents opens wider room for experience sharing. Elders can also get a chance to transfer their knowledge and experience to the next generation. In countries like Ethiopia where most of the knowledge is transferred orally such forum is quite important.

#### *Forum to develop culture*

Cooperatives could also serve as a means to develop culture. Culture is the result of social integration and networking. This would be important for Ethiopian in view of Art 39 (2) of the FDRE constitution which recognizes collective right to develop language, culture and history.

## **10.6 Cooperative autonomy: assistance of the State and NGOs**

### **Cooperative autonomy: A must for long lasting survival**

Principle of cooperative autonomy has to be strictly adhered to by the cooperatives. If the cooperatives are unable to maintain autonomy against the interference of, political interest may inroad into the community. Such type of community becomes either identical to the lower level political administration or a source of conflict especially in Ethiopia where there has not been

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<sup>38</sup> Barbara Warner, Elizabeth Beck and Mary Ohmer, 'Linking informal social control and restorative justice: moving social disorganization theory beyond community policing' (2010) 13(4) Contemporary Justice Review 355-369

<sup>39</sup> Ibid

national consensus. Lack of political neutrality reduces the chance of residents joining the cooperatives and the non-members may work for the dissolution of the community. Furthermore, the political issues may overshadow the issue of building social solidarity.

#### **A. State assistance**

In addition to the special privileges recognized by the Ethiopian Cooperatives Law the state may empower the cooperative community by recognizing some acts of the cooperatives or delegating some state powers to the cooperatives. For example, the state may give recognition to the acts of the cooperative community on matters such as the conclusion of marriage or dissolution of marriage by mutual agreement and its consequences thereof. Moreover, it may legitimize the power of cooperative community to give references for individual members of the cooperatives. In rural areas the cooperatives community may be authorized to play a conciliation role in land related disputes.

The state should, however, refrain from lobbying about the importance of cooperatives or giving technical and professional assistance since such acts undermines the autonomy of the cooperatives and may also redirect cooperatives away from its agenda of building social solidarity.

#### **B. NGOs Relation to Coop Community**

NGOs should limit itself in financial assistance only. The NGOs should not be allowed to give any training whatsoever. Although, they can provide information in any form the interpretation of such information should be left to the community.

## 10.7 Conclusion

Thus this Chapter Ten has shown that cooperatives would be used to build trust. In Chapter Nine it is shown that trust would revive if community life revives. This Chapter shows that cooperatives are best alternatives to revive community life. There are many reasons make cooperatives best alternative to rebuild traditional community. Firstly, cooperatives have theoretically and practically been engaging in community building activities and hence have ample experience. Secondly, compared to state or even other entities such as NGOs, cooperatives have sufficient time to work on rebuilding of community. Thirdly, they are association of local residents who aim to resolve collective problem through collective action. Traditional communities have been collective action of local residents to resolve collective problems. Lack of trust is a collective problem that can be solved only through collective action. Fourthly, cooperatives can increase the interaction between residents by serving as a local market, forum of social gathering and facilitating intercommunity relationship. Such interaction would give rise to the development of networks and local norms. Fifthly, since membership in a cooperative can be on the basis of rational choice they would not be resisted by those who do not value community life. Six, Cooperatives could be managed by the elderly and according to the local custom. This primarily helps to revive the traditional values. The fact that cooperatives could limit their major task to selling and/ or buying on behalf members and instead add additional subsidiary tasks such as giving reference to resident member, giving information to the government, preventing crime, transferring informal knowledge, and developing local culture would also enable them to rebuild community. Cooperatives could also serve as best alternative channeling support for those (state, NGOs or even investor owned firms) who want to support the revival of community.

## CONCLUSION

The utilization of cooperatives for a variety of purposes by a plethora of different institutions greatly reduces the comprehensibility of cooperatives. The cooperative form of organization has had many non-profit motives that have emerged from multiple sources. These motives were motivated by: economic self-defense, self-help, community building, cultural transformation, political intervention by a State into an economy, poverty eradication, and the ending of a caste system. The motives are largely dependent on the impetus behind the cooperative movement, that is whether it was motivated by the people involved (self-motivation), motivated by the state pursuing a political aim or whether it was motivated by philanthropists pursuing philanthropic ideas.

Cooperative organizations that emanate from members' self-help motives are the result of freedom of association and freedom of contract and are mainly concerned with members' economic and social challenges. The fact that these cooperatives are half way between investor-owned firms and charities confuses the identity of the cooperative with that of the investor-owned firms. This opens a gap for the emergence of cooperatives that have profit as their motive.

Cooperative Organizations that are initiated by the Government are half way between public enterprises and investor-owned firms, and have a political motive of either transforming the culture of society or regulating the economy. The Government often use cooperatives as an instrument to transform the culture of the society, such as a return to colonial Africa or the Communist Governments of Eastern Europe. Alternatively they can use cooperatives to interfere in the economy, which is how cooperatives have manifested in many African and South East Asian countries. In order to attain its objectives, the Government usually gives away some privileges to these typically rent-seeking cooperatives. This has led to a risk of cooperatives becoming too similar to investor-owned firms, and in turn, foregoing their public objectives in the process.

Cooperatives could also be organized by community members to defend traditional, community values or used by philanthropists to facilitate progress, such as to fight poverty and injustice. However, the flexibility of the cooperative has led to cooperatives becoming indistinguishable from other forms of company.

True cooperative movements have lost their moral underpinning and many now work towards profit-maximization objectives. This is because true cooperatives have been declining since the Second World War, and particularly after 1970 due to external factors such as the changing role of a state in the national economy, the efficiency of hypermarkets, the emergence of consumer movements, the effects of globalization, and at a national level, factors such as financial challenges which have led to a decline in cooperatives. As a result, many cooperatives were either dissolved or converted to investor-owned firms or modifications have been made to the principles upon which the cooperatives have been established.

There have also been considerable moves by entrepreneurs to utilize the cooperatives to exploit Government incentives. It is self-evident that the ultimate aim of entrepreneurs' is to maximize returns from investments, and to that end, they will select the form of company which gives the greatest incentives. The central issues that an investor considers in determining the form of organization are transaction costs, management costs and risk. Thus, if the cooperative form of organization proves more efficient on these criteria the entrepreneur will not hesitate to form their business under this umbrella. By understanding the theory of how firms operate as explored earlier in this thesis, it demonstrates there are situations that cooperatives can be the best form under which to organize their company. For example, transaction costs may be minimized if the firm is assigned to the suppliers of raw materials. Transactional costs would also be minimized if the ownership of the firm is assigned to those who become losers when price is distorted by unfair trade practices, gradual labour specialization, immobility, and asymmetric information. There will be fewer legal barriers that limit the entrepreneur to grab the cooperative form of organization, since cooperatives are normally the result of freedom of association and freedom of contract.

The Ethiopian cooperative law, policy, and practices have done little to distinguish cooperatives from investor-owned firms. The law that governs cooperatives in Ethiopia is the Cooperative Society Proclamation No.147/1998. But this law fails to distinguish cooperatives from investor owned firms at all level beginning from definition, formation and liability and extending to principles, ownership and management. Cooperative policy of the government may be expected

to remedy the defect but it does not exist. The practice is further exacerbating the defects of the law and the absence of policy.

One may ask why one worries about distinguishing cooperatives from investor-owned firms in Ethiopia. The answer would immediately be clear when one realizes that Cooperatives in Ethiopia are entitled to robust benefits that are not available to investor-owned firms. Cooperatives are entitled to priority claims on the property of the member, set-off in respect of shares or benefits of members' share or benefit of a member in a cooperative not liable to attachment, administrative ease, income tax exemptions, and government assistance. Investor owned firms are not entitled to these privileges although cooperatives are entitled to all other benefits of investors owned firms. These privileges need to be justified before they are dispensed readily to firms who may operate under the disguise of a cooperative.

The definition of cooperatives is now incomprehensible. This is because besides being silent on issue of profit, it confuses the definition of 'cooperative society' with the definition of 'society' and more importantly it equates the word 'voluntariness' with defect free consent in contract. The cooperatives are defined on two levels: the first definition is about 'cooperative society' and the second is about 'Society.' Although this might have been intended to make distinction between registered and unregistered ones it pushes one to believe that cooperative societies are different from societies and are outside of the ambit of the Cooperative Society Proclamation No. 147/1998. More importantly, in the proclamation the definition of cooperatives society contains 'voluntariness' as its basic element but there is an indication that it is equivalent to defect free consent which is essential element of contract. But in cooperatives voluntariness goes beyond defect free consent and implies some form of charity commitment. The definition is also silent about the issue of profit and this may open the room to bring other parts of the proclamation specially provisions dealing with distribution of surplus and capital contribution to conclude that profit maximization is the central theme of cooperatives.

More surprisingly, under Ethiopian cooperative law, a cooperative member's money is more important than his moral commitment to the ideology of the cooperative. This is because the capital of cooperative is fixed and a person joins a cooperative only if he agrees to contribute a



certain amount of money to the capital of the cooperatives and pays at least a quarter of this money. The law also allows the sale of shares to persons living outside the local area of the cooperative. Moreover, the content of by-laws of cooperative is the same with the memorandum of association and articles of association.

We may expect that the above definitional and conceptual defects may be cooled down by the principles of cooperatives. But such is not the case. The Cooperative Society Proclamation No.147/1998 modifies the cooperative principles. Cooperative principles and ethics would help a cooperative to make sure that it has been moving on the right track. Furthermore, cooperatives could be fully understood only by having enough understanding of these principles. Any change of the principles means change of the cooperative goal. However, although the proclamation provides voluntariness, democracy, autonomy, education, cooperation and sustainable development it underemphasizes the principle of open membership and excluded mutuality principle. The principle of open membership is a key principle to distinguish cooperatives from investor-owned firms. The principle of cooperative education also fails to include or at least gives very less attention to the ethical training for members.

One may expect that ownership under Cooperatives is indivisible as against divisible ownership in investor owned firms. But that is not the case. Under Ethiopian Cooperative law, freedom of contract allows profit seekers to organize producer, worker and consumer cooperatives. This is because, although there is some restriction on the right to transfer ownership right in cooperatives, such restrictions can be eased by the by-laws. Moreover, cooperatives are entitled to reinvest in investor owned firms, they can provide service to non-members, there is a possibility of closed membership and unlimited share capital, there is very small legal reserve fund and its utilization is unregulated, profit-sharing is on the basis of capital contribution, and there is wider rights to transfer shares.

Furthermore, the management is accountable to owners only. Under Ethiopian cooperative law, there are three key management organs of a cooperative: the general meeting, the management committee and the control committee. General meetings are a meeting of members of cooperatives. The management committee means a body elected by the general meeting with the responsibility to manage the activities of the society. The control committee is a committee

established by the general meeting to audit the activities of the management committee. The members of the management committee and control committee are normally members of the cooperative. The Federal Cooperative Agency has no power to over see the decisions of the meeting. More interestingly the Ethiopian cooperative law leaves much more freedom to the general meeting than Commercial law leaves to the shareholders' meeting. The management committee and the control committee are accountable to the general meeting. The general manager could be made to be accountable to the management committee. This implies that cooperatives could follow the management style of investor owned firms if such style could maximize profit.

Cooperatives are also indistinguishable from investor owned firms on basis of the government policy or their day to day activities or their regulation. The law does little to keep cooperatives distinct from investor-owned firms, but does public policy? The Government might have a policy that it can address only through cooperatives and that policy objective may then enable us to distinguish cooperatives from investor owned firm. Or, although the Government might not have such a policy, the cooperatives might in practice been caught with non-profit maximizing motives. Finally the existence of cooperative regulation would also help us to keep cooperatives distinct from investor-owned firms. However, none of this was found to exist in Ethiopia.

Although the existence of special privileges to cooperatives makes us expect a public interest behind cooperatives, the Ethiopian Government does not have any public interest objectives that can be attained purely through the use of cooperatives. The Ethiopian Government claims to be a developmental state. That means the power of the Government is limited only by economic rationality. Thus the Government can direct investor owned firms to whatever objectives that ultimately lead to economic growth through a carrot-and-stick approach or establish public enterprises whenever necessary. Thus, cooperatives in their proper sense becomes of no use. In practice also Ethiopian government does not have any clear ultimate objects that it wants to attain through the instrumentality of cooperatives. Although it may be claimed that the Government have intended to use cooperative as instrument to interfere in the agricultural economy by using them as a medium of agricultural product marketing and distribution of agricultural technology such allegation is less convincing since the government has other better alternatives. Moreover, the confusion between policy and strategy committed by the Ethiopian

Agricultural Transformation Agency while it was developing Agricultural Cooperative Sector Development Strategy 2012-2016 implies the non-existence of a clearly articulated government cooperative policy. This would further be evidenced from differing interpretations given to cooperatives by different state organs and relegation of non-agricultural cooperatives. One may agree with the non-existence of clear and elucidated policy but could still conjecture that the government might have intended to use cooperatives as an instrument of channeling basic goods/services to the consumers, saving and credit alternative, and poverty reduction strategy but such conjecture holds no water where the Ethiopian government has unlimited alternatives to interfere in the economy.

However; evidence gathered indicates that the Government has been attempting to use cooperatives as an instrument to control inflation, channel agricultural marketing, mobile rural saving and forum of political indoctrination although such attempts have been unsuccessful due to rent-seeking tendencies both in the part of the Government and the cooperatives. The Government rent-seeking tendencies are apparent from its desire to use cooperatives as a forum of political indoctrination. The profit seeking objective of the cooperatives would be inferred from the behaviour of the cooperatives and cooperators such as the appointment of general managers, profit sharing on the basis of capital contribution, transactions with non-members, investing in profit seeking firms and compromising principles of autonomy, education and coordination. In short, cooperatives in Ethiopia do not have any not-for-profit vision and the Government has been unable to direct them to its own vision.

Cooperatives are neither self-regulated nor state regulated and hence they are free to act as they deem it proper without limit like investor-owned firms. The lack of individual motives to cooperate, the absence of cooperative ideology and the non-existence of apex organization implicates the non-existence of cooperative self-regulation in Ethiopia. Cooperative regulation by the state has become impossible due to the lack of constant and strong Government commitment and the lack of legal framework.

Regulation of cooperatives refers to the mechanism of ensuring the adherence to cooperative principles. Regulation may be either self-regulation or state regulation depending on the sources of the objectives of the cooperatives. If the cooperative movement is from below (initiated by

members) or side(initiated by philanthropists), the regulation is mainly self-regulation but if the cooperative movement is from above(initiated by the government), state regulation is necessary.

Three things are essential for cooperative self-regulation to exist. The first thing is strong motive (vision) of members behind the cooperatives mission/goal. However, since the Ethiopian Government has been taking responsibility for almost every problem of individuals, individuals are not accustomed to solving problems collectively. This means individuals do not have any concern to form a cooperative. Even if it is formed members never worry whether or not the cooperative is properly functioning since they get or lose nothing. Cooperatives as instrument of self-help become less important since individuals become passive in respect of their own problems. The second important thing is cooperative ideology. Cooperative ideology is a belief in self-help, self-sufficiency and autonomy. However, since it is the Government that has been organizing the cooperatives in Ethiopia such ideology has not got a ground to flourish. Due to lack of motive to cooperate and lack of cooperative ideology combined with state interference there is no apex cooperative organization in Ethiopia, which is third important point for self regulation.

Two things are essential for the government to regulate cooperatives. The first thing is policy commitment. However, since the Ethiopian Government has unlimited alternatives to interfere in the economy it lacks constant and strong motive to regulate cooperatives. The second issue is the legal framework that enables the Government to interfere into the internal affairs of cooperatives. In Ethiopia there is no such framework because the cooperative principles laid down in the Cooperative Society Proclamation No. 147/1998 do not have legal effect, special privileges are indiscriminately available to everyone registered as cooperative, and the power of the Cooperative Agencies is limited to supporting cooperatives without any power of supervising and controlling. Moreover, the express recognition of principle autonomy serves as a pretext both for the Government not to take responsibility for the improper functioning of cooperatives and for the cooperatives to use it as a shield to remain in their wasteful behaviour.

Having examined cooperatives from, a general theoretical overview, through Ethiopian cooperative law, through Ethiopian cooperative policy and Practices there is little to distinguish cooperatives from investor owned firms. This indicates that cooperatives in Ethiopia are little more than wasteful rent-seeking organizations and a missed opportunity to improve Ethiopian

society. I have therefore attempted to find other solutions to resolve the dilemma and make the cooperatives responsible for the special privileges the public is giving them. I have three alternatives. The first alternative would be to abolish the Cooperative Society Proclamation No.147/1998 altogether. The second alternative would be to redefine cooperatives so that the Cooperative Society Proclamation No.147/1998 governs only cooperatives that play the role of a commission agent to its members (who should be nobody but either producers of primary products or consumers or workers). The third is the second alternatives with the additional task of using cooperatives for community building.

According to the first alternatives cooperatives should be merged with investor owned firms. If the government wants to encourage producer-owned or consumer-owned or worker-owned firms this would be done by other legislations that deal with incentives to investors. Moreover, it is preferable for the government to use such incentive or to establish public enterprises to intervene into the economy. The second alternative limits cooperatives to the mutuality principle of user owner, user control, and user-benefit. The cooperative buys goods/services by their own name but for the benefit and on behalf of members.

However, such alternatives neglect the role of cooperative in solving social problems<sup>1</sup> that has less direct link with market economy and the state or charities can never solve such as building morality. Historically, cooperatives were self-help organizations. That means they have been solving problems that require collective action that the market or the state or charities failed to resolve. Cooperatives should continue to play this role.

Although the state has been intervening into the economy, it has neglected the issue of morality especially trust. A lack of trust undermines human relations which in turn undermines civilization. Moreover; trust improves educational performance, reduces the cost of transactions, improves health and reduce crime. Trust is also the foundation of rule of law and without the rule of law human relations are unimaginable.

The sources of trust are religion, morality and community life and these are declining. Very little can be done to save religion and morality but community life could be saved. Cooperatives are

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<sup>1</sup>See Merrett, Christopher D. and Walzer, Norman (eds.) Cooperatives and Local Development; Theory and Application for the 21<sup>st</sup> Century 2004 pp.275-279

good mechanisms with which to build community life. Rebuilding communities is especially urgent in Ethiopia since Ethiopian Society has been in transition. The traditional community has been disintegrating without any visible substitute that would take over its task. Moreover, the state has limited capacity to enforce formal laws and unless the law enforcement burden is shared by the community the rule of law could be crippled. The simultaneous constitutional recognition of rights of nations, nationalities and the freedom of residence, the urgency of democratization process, and the immaturity of the media in Ethiopia are also problematic areas.

Consumer cooperatives could be a replicate of a traditional community in modern form. This is because it is generally an association of residents of the same locality, it is less occupied and it is a forum for individual interactions. Historically, also it was designed in the beginning to build a community of 'new moral world. Membership should however, be on the basis of individual rational choices so that individual rights would not be endangered by the formation of the community. Moreover, the community cooperative should better be under collective management to avoid any possible emergence of individual dictator that undermines the community. Preferably, elderly members of the community cooperative should be members of the collective management since they could have the knowledge, commitment, integrity and time necessary for the duty. Reviving the management style of the local community is also advisable to further facilitate community consolidation and avoid any possible resistance from those who want to maintain local culture.

In order to concentrate on the community building task, the community cooperative should not involve in any form of production. It should limit itself in retail and wholesale trade (retail on local (primary) cooperative level and wholesale on union level) and service delivery. However, to strengthen its community building task, it may carryout social activities such as providing reference to individual members, community surveillances, a forum for informal knowledge transfer and a forum for local culture.

Although assistance from outside may be useful, cooperative autonomy is a must for a long lasting survival of the community cooperative. State assistance should be limited to extending special privileges and delegating some of its sovereign power to the community cooperative. Charities should limit themselves to financial aid and information supply. Advocacy of

whatsoever nature either by the state or charities should be absolutely prohibited. Community cooperatives could however, be business partners of manufacturers, importers and wholesalers.

Thus cooperatives have been uncategorizable from investor owned firms generally because of the declining of their traditional objectives, and enterprises move into cooperative form of enterprise and particularly in Ethiopia due to legislative and policy failure and due to lack of cooperative regulation. Ethiopian Cooperative would be distinct enough if the law redefines them as community building economic associations.

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## IV. Interviews

Interview with Ato Daniel Legesse, Addis Ababa Saving and Credit Cooperative Union Ltd, General Manager, August 3, 2014, Addis Ababa

Interview with Ato Fikre Mekuria, Board Chairperson, and Ato Tewodros Taddele, General Manager, *Mierab Kolfe* Consumers' Cooperative Union Ltd August 5, 2014, Addis Ababa

Interview with Ato Gadissa Eda'a, Finance Head, Oromia Coffee Farmers' Cooperative Union, February March 8, 2013, Gelan

Interview with Ato Ayele Bedane, Certificate Officer, Oromia Coffee Farmers' Cooperative Union, F March 8, 2013, Gelan

Interview with Girma Regassa, Legal Service Head, Oromia Coffee Farmers' Cooperative Union, February March 8, 2013, Gelan

Interviews with Ato Tesfaye Wami, Legal Advisor and Promoter, Inspection, Audit and Legal Service Work-Process Main Unit, August 4, 2014, Addis Ababa

Interview with Ato Mulugeta Mengistu, Head, Promotion and Development Work-Process Main Unit Cooperative Promotion and Development Sector, Trade and Industry Bureau, Addis Ababa City Administration, , August 3, 2014, Addis Ababa

Interview with W/ro Birke Melaku, Cooperative Promotion and Development Coordinator, Cooperative Promotion and Development Work-Process Main Unit, Trade and Industry Sector, Arada Sub-City, Addis Ababa City Administration, August 4, 2014, Addis Ababa

Interview with Ato Abinet Melese, Senior Cooperative Promoter, Cooperative Promotion and Development Work-Process Main Unit, Trade and Industry Sector, Arada Sub-City, Addis Ababa City Administration, August 4, 2014, Addis Ababa

Interview with Ato Tesfaye Mathios Kalo Cooperative Societies' Organization and Registration Officer, Marketing and Cooperative Office, Hawassa City Administration, June 25, 2014, Hawassa

Interview with Ato Michael Ayalew, Senior Legal Expert, Federal Cooperative Agency February 24, 2014, Addis Ababa

Interview with Ato Zelalem Hailegiorgis, Business Statistics Directorate Director, Ethiopian Central Statistics Agency, July 31, 2014, Addis Ababa



Interview with W/rt Mekdes Yonas , Record Officer, Cooperative Society Promotion & Development Sector, Trade & Industry Bureau, and Addis Ababa City Government, July, 30, 2014, Addis Ababa

## V. Government Policy Documents<sup>1</sup>

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የዲሞክራሲ ስርዓት ግንባታ ትግልና ስብዮታዊ ዲሞክራሲ መጋቢት 1999 ዓ/ም (Democratic System Establishment Struggle and Revolutionary Democracy March 2007)

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የተሃድሶ ዉመስመርና የኢትዮጵያ ህዳሴ ህዳር 2003 ስድስት ስብሰባ (The Reform Programme and the Ethiopian Renaissance November 2009 Addis Ababa)

የሰማታዊ ዲሞክራሲያዊ ስርዓት ግንባታ ትግላችንና ፈተናዎቹ ሐምሌ 2006 (Our Struggle to Build Developmental Democratic System and Challenges July, 2014)

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<sup>1</sup> Policy documents presented in Amharic (Federal Working language) do not have English Version. Believing that the title could give some clue about the content of the documents I have provided my personal translation in the bracket

## **Appendix - Interview Manuscript<sup>1</sup>**

### **A. Interviews with Oromia Coffee Farmers' Cooperative Union Officers, Gelan, State of Oromia**

These interviews were carried out in March 2013. The members of this union are cooperatives of small hold coffee producers in the state of Oromia, the biggest state in terms of size, population and coffee production. This cooperative union is one of the biggest and more organized unions. These qualities are the major factors why I select it for my interview. In order to get the consent of the officers for the interview I was required to file an application setting out the information I wanted and the purpose for which I intended to the information. Accordingly I wrote an application letter that contained the thesis of my research and specific information I wanted. I was then allowed to talk to the following officers of the cooperative union. The interviews were made in person. I present the specific interviews as follow: I made at most care to transcribe the full ideas of the interviewees. I transcribed here the answers of the interviewee believing the questions could be easily inferred from the answers.

#### **Gadissa Eda'a 'Interview with the Finance Head' (8 March 2013)**

1. The Cooperative Union was established by the decision of the government with the intention of solving the problem of issuing check without sufficient fund to small hold coffee producer peasants. Coffee dealers had developed a custom of cheating and exploiting the business inexperience of the peasants by issuing a check that was not accepted by the paying bank As coffee has been taking a lion's share in Ethiopia's export earning the problem was seriously taken by the Government. Hence the Government decided to establish and took the initiation to establish coffee producers' cooperatives that collect the product from the peasants and transfer it to the

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<sup>1</sup> All my questions in the interview were open-ended questions. I made at most care to transcribe the full ideas of the interviewees. I transcribed here the answers of the interviewee believing the questions could be easily inferred from the answers.

- cooperative union that further supply to the international market. Problem of the farmers to access to loan was also another pushing factor.
2. In addition to voluntariness, the size of coffee plantation of the individual member of the primary cooperative, the size of annual supply to the union and support letter from the Wereda administration (the second lowest political administration, the lowest being kebele)
  3. Dividend is distributed partly on the basis of share capital contribution and partly on the amount of transaction.
  4. The union is free of income tax but it collects value added tax on all transaction it enters into.
  5. The union received the land up which has built not for free; it has paid compensation for the peasants who were occupying the land. Recently the Government has begun to demand lease price in addition to the compensation to the land holders to be removed. In fact the union has not able to get plots of land to construct coffee processing factors near the peasants' residences.
  6. The union makes annual report to Oromia Cooperative Agency. The government also appoints external auditor by tendering international auction. All expenses concerning the external audit are born by the union. There is quarterly internal audit.
  7. The union purchases coffee only from members in order to ensure the traceability of the coffee for the purpose of international market. But it gives other services such as coffee washing and packing to other non-members.
  8. More than fifty percent of members are nominal members who do not supply their product to the union but to sell to the market for better price.
  9. Some times the cooperatives may be the property of the manager or board of directors. Corruption is rampant in cooperatives.
  10. Access to loan is also very difficult due to corruption. Since coffee market does not exceed two months delay in loan release makes the loan of no use.
  11. There is government interference in the cooperatives. Cooperative autonomy does not exist or at least impossible. Cooperatives are under the government control.

12. The government has less commitment to promote cooperatives although resource is sufficiently available to make promotion. The cooperative promotions organs of the government are weakly organized.
13. The cooperative movement has a hidden agenda of dismantling and substituting the lowest level of political administration.

**Ayele Bedane, ‘Interview with the Certificate Officer’ (8 March 2013)**

1. The central objectives of cooperative union are to enable members to receive fair price for their product. In fact the government decided and initiated the establishment of the union in order to rescue coffee producing peasants from fraud of check without sufficient fund. The amount of coffee production and the size of coffee plantation are major criteria. Those having more than five hectares of coffee plantation are not entitled to become members.
2. Profit distribution is decided by the general meeting on the basis of the report of the board and external auditor.
3. The union provides loan to the member cooperatives.
4. The union could purchase from non-members if the supply of the members is below its purchasing plan.
5. The union is now a perfect trader. It has already received trade license as exporter and it is a big exporter. It makes large annual profit and has already out of the truck of true cooperatives.
6. The government has repeatedly scolded the union for becoming a profiteering organization. The government is not also happy with the large size of the union’s capital and membership.
7. The union does not believe that the government is giving it a special privilege. For example although the law exempts cooperatives from court fee such is not practical.
8. The government does not respect the autonomy of the union.
9. Membership is open.

**Girma Regassa, ‘Interview with Legal Services Head (8 March 2013)**

1. Dividend is distributed partly on the basis of share capital and partly on the basis of annual transaction with the cooperative. However; the members of the union are demanding that it should be based totally on the basis of capital contribution.
2. The union has share holding in Oromia Insurance Share Company and Oromia Cooperative Bank Share Company.
3. The union can carry out any kind of economic activity for gain with out any to get additional trade license once it got the trade license.
4. The union has not obtained for free. The right to access to land for free has not been respected.
5. Due to high rate of corruption and untrustworthiness, the cooperatives would less possibly attain their true objectives.
6. The manager is a professional employee and his monthly salary is fifteen thousand birr(about five hundred pound).

**B. Interview with Hawassa City Administration Marketing and Cooperative Society Office Promotion and Registration Officer, Hawassa, the State of SNNP.**

This interview was made in person. I introduced the purpose of my research and directly entered into asking questions I prepared in advance. I transcribed here the answers of the interviewee believing the questions could be easily inferred from the answers.

**Tesfaye Matewos Kalo, ‘Interview with Hawassa City Administration Marketing and Cooperative Society Office Promotion and Registration Officer’ (26 June 2014)**

1. Factors that distinguish cooperatives from investor owned firms are that their members are individuals that have low or middle income.
2. Cooperatives may be organized by the members to have easy access to government subsidized basic consumption commodities.
3. Although Cooperatives could sell to non-members they should first satisfy the demand of their members.
4. The government controls cooperatives if they are supplying basic goods that the government is empowered to control their distribution according to Competition and

Consumer Protection Law. This is to make sure that they are selling the goods following the specified quota or quoted price or both and to a specified destination.

5. Although there is a legal right to access land use right such right has been gradually blocked.
6. The government supports the cooperatives by controlling the management through audit, inspection and training. The government also assists cooperatives by searching better market for their products.
7. The cooperative law and the cooperative practices are quite opposite especially in housing cooperatives.
8. No cooperative has been demanded to pay tax contrary to the law.
9. The Saving and Cooperatives have been practically more successful and useful to their members
10. The ultimate objectives of the government mutual development, saving, market stabilization, creating culture of honesty, transparency and accountability. Especially cooperatives are more preferable in market stabilization since the private sector is untrustworthy.
11. Major challenges that the cooperatives are failure to give priority to members. Consumer cooperatives have been tempted to sell to non-member at a better price. Poor accounting and lack of enthusiasm in the part of the management to participate in the training courses and seminars made available by the government. To solve the problem of lack of enthusiasm the government has gone to the extent of paying per diem to the trainees. The government has also been working on cooperative promotion so that public awareness about of the use of cooperative increase.

### **C. Interview with Federal Cooperative Agency Officers, Addis Ababa**

The Federal Cooperative Agency is a federal government organ established to promote and register cooperatives at a federal level. To get this interview I went to the foreign relation officer and he directed me to the interviewee. Then after I introduced the reason why I want the interview I immediately and directly began to ask questions I already prepared.

#### **Abera Bekele, 'Interview with Public Relation Officer' (March 11, 2013)**

1. The purpose of cooperatives are improving saving culture, serving as a bridge to technology transfer, adding value chain (adding value to products at every level of transaction, ensuring balanced economic development( reducing the gap between the rich and the poor by subsidizing cooperatives which would be owned low income earner), creating work opportunity, reducing over urbanization and facilitating market.
2. Dividend distribution is 40% on share capital and 60% on amount of annual transaction.
3. There is no cooperative policy for agricultural cooperatives.

#### **Michael Ayele, 'Interview with Senior Legal Expert' (March 11, 2013)**

1. Although the Federal Cooperative Commission has developed a project by buying consultancy service from UKCC to open Cooperative College it is not clear whether the government would agree and assign necessary budget
2. The Ministry of Revenue and Custom Authority has been forcing the cooperatives to pay income tax as if they are investor-owned firms. Paradoxically, the Ministry has refused to recognize cooperatives as investors. The Ministry of Transport has recently classified cooperatives into category of Charities and Societies (Non-profit making associations) while registering vehicles.
3. The Federal Cooperative Commission has made repeated discussion with concerned government organs so that they accept its advice as to how to deal with cooperatives but still there has not been any significant improvement.
4. Oromia International Bank Share Company is an investor-owned firm in which the cooperatives have invested their money.

5. The Federal Cooperative Agency in collaboration with regional agencies has been promoting and assisting the formation and strengthening of agricultural cooperatives. To further strengthen the process an Agricultural Cooperative College has been considered. The government has also planned to introduce certification and rebranding of agricultural cooperatives.

#### **D. . Interview with Addis Ababa City Administration Cooperative Society Officers, Addis Ababa**

This interview is made by directly contacting the persons to whom I wanted to talk. That is I myself chosen the individuals by taking into account their official position

#### **Interview with Ato Mulugeta Mengistu, Addis Ababa Trade and Industry Bureau Cooperative Promotion and Development Work-Process Main Unit Head, (3 August 2014)**

1. Housing Cooperatives are part of the government housing project. However; land has not yet been allotted. Before 2005 Housing Coops would not be registered unless there had been a plot of land to be transferred to the registered Coops. But now that has been changed and it is enough for the Coop to deposit 50% of estimated construction cost. The major purposes of HC are saving of land, creating consumer coops, developing common infrastructures. The HC is not expected to construct houses on the land it receives. Its major role is to organize members on matters that is common to all members.
2. Cooperative Societies are engaging in business activities.
3. Membership criterion to Consumer Coops, in addition to those criteria indicated in the Ethiopian Coops Law, is being a resident of a kebele in which the consumer coops are established. Only one coop can be established in one kebele. Although there is constitutional right to association the Work-process Main Unit Head has limited such rights so the consumer coops would be big enough. The minimum number of members of primary consumer coops shall be two hundred.
4. The government has been making repeated and intense promotion so that a consumer coop could register at least fifty percent of the kebele residents as its members. Although there is no data that shows the increase of membership of a consumer coops, the coops



are doing hard to increase their members and they have been showing remarkable success in this regard. The consumer coops are induced by the fact that they can become full owners of the kebele property that has been used to supply goods/services to the local community.

5. The government makes sure that coops could not be disguised traders by requiring coops to deposit 30% of their profit in a government account. Moreover; members are encouraged to use their dividends to buy additional shares so that the capital of the coops could be raised.
6. When coops are dissolved they are expected to return to the government the land that was freely assigned to them. All the land freely given to coops are registered by the name of Addis Ababa City Administration Trade and Industry Bureau.
7. The reason why the government is not willing to authorize the establishment of Cooperative Banks is because the government is not willing to loss the deposits that Saving and Credit Coops have in government owned banks.

#### **Tesfaye Wami, 'Interview with Promoter and Legal Advisor' (4 August 2014)**

1. The major challenges to cooperative movement in Ethiopia are;
  - a) Lack of cooperative policy. This is the primary challenge to cooperative movement. The government has given less attention to the cooperatives since the government is not willing to see them controlling the market. They are controlling the export and import market. They are also controlling large number of population as their members. For example in Addis Ababa more than 23% of the residents have already become members of the consumer cooperatives.
  - b) Legal imposition of maximum shareholding. If the cooperatives are expected to move towards business the law should not limit the maximum share capital of a member. Such has to be determined by the by-laws.
  - c) Less willingness in the part of the new generation to join cooperative.
  - d) Lack of enthusiasm in the part of the management. This is mainly because they carry out their duties gratuitously.

2. The government controls cooperatives through inspection, audit and legal service. Inspection includes checking the management structure that is the existence of necessary management organs as indicated by the Cooperative Law. Inspection also includes checking the existence of necessary office organizations such as work manuals, by-laws and articles, and auditing and inspection manuals. The Inspectors also check the existence of managers and necessary staff members and infrastructures. Cooperatives' relation with government and other higher cooperatives is also point of inspection. The inspector would also check whether or not the cooperative is keeping proper records such as accounting and minutes, working in accordance of the Cooperative Law and the number of meetings held in the inspection period. On the basis of his finding the inspector gives comment to the management committee or the general manager. He also reports his finds to the government. Auditors do the same thing with the inspector but the auditor emphasis the financial accounting. In addition to giving comments to the management of the cooperative they report any fraud or mismanagement to the government. On the basis of the report of the auditor the government may institute a court action against those responsible for the fraud or mismanagement.
3. Government interferes into daily affairs of cooperative very rarely. However; until the cooperatives become competitive in the business realm the government should continue to support them. The government has to act as a guardian/tutor until they become matured enough. This means the government goes out of the promotion and development when cooperatives become business organizations (investor owned firms).
4. Most employees of Cooperative Promotion and Development Office of Addis Ababa City Administration are members of saving and credit association but only few of them are members of consumer cooperatives.
5. Consumer Cooperatives in Addis Ababa are highly profitable but profit could not be distributed until fifty percent of residents in the locality of the consumer cooperative become members.

**Birke Melaku and Abinet Melese 'Interview with Coordinator and Higher Promoter', Arada Sub-City (4 August 2014)**

1. There is less willingness in the part of the public to join cooperatives. This is because;
  - a) The public believes that membership in a cooperative brings no better benefit whatsoever. Since the members of the cooperatives usually reinvest any share in the annual surplus on the basis of the decision of the general meeting the public is unable to see the actual benefit of cooperatives. Moreover, since the government has already ordered the cooperatives to provide their service to non-members and even to retail traders the benefit of the cooperatives has remained invisible to the public. Hence it has become difficult to convince individuals to join cooperatives.
  - b) Lack of awareness in the part of the public despite the effort of the government to promote cooperatives.
  - c) Profit-motive of cooperators. Some cooperators believe that they are entitled to make unlimited profit from the cooperative's economic activity. This motive goes to the extent of refusing to admit new members under the guise of the by-laws and the Cooperative Law that authorize the general meeting to decide on the admission of new members.
2. Major challenges of the cooperative movement are:
  - a) Unwillingness of members to attend the annual general meetings. It has been a general trend to cancel the annual general meeting due to lack of quorum. As a result it has even become difficult to decide on the distribution of dividends.
  - b) Government decision to use cooperatives as a channel to distribute basic goods/service to the public. This has not enabled cooperatives to function according to the principle of mutuality.
  - c) The government prohibition of the distribution of annual profit. Consumer cooperatives are expected to keep separate book of account for the revenue they derive from shops, recreation centers, public schools etc that has been transferred to them from kebele administration and no profit would be distributed to members until at least fifty percent of the residents of the kebele become members. This fact has created a stalemate where the members are unwilling to increase membership for fear that the new comers would reduce their share in the profit especially the accumulated profit. The government also discourages dividend from any source to pay distributed to members.

3. Workers' Cooperatives in Addis Ababa City Administration has been ordered to be converted into investor owned firms because they were frequently violating cooperative principles. Now the City Administration does not register workers' Cooperative.
4. There are cooperatives that have profit maximizing objectives. Even some fiercely argue that they are entitled to profit maximization motives.
5. The government pays office allowance and telephone fees for the management committees and the general managers of cooperatives.

## **E. Interview with Saving and Credit Cooperative Union Officer, Addis Ababa**

**Daniel Legesse, 'Interview with Addis Ababa Saving and Credit Cooperative Union Manager, (3August 2014)**

1. Coops have their own general manager.
2. The role of union is to provide loan beyond the by-laws of primary coops. Primary coops give loan on the basis of saving but unions give loan on the basis of credit worthiness of the borrower.
3. Primary coops could give loan only to their members but unions could give loans to member primary coops or individuals members of such primary coops. Unions may also extend loans to other non-member coops especially to consumer cooperatives.
4. The government makes strict control on coops. From the beginning especially in producer and consumer coops it is the governments that originates the business idea and then invite individuals to buy the idea. The government advocates its business idea through its employees. Once the advocacy succeeds the government itself prepares the by-laws and makes the volunteers to sign the by-laws. The founders of the coops are not entitled to make even a slightest change to the by-laws presented by the government. The government even goes to the extent of controlling employment contracts of the coops. There has been annual inspection and audit, which go beyond financial accounting. Therefore; coops are under the feet of the government from moment of inception to dissolution.
5. There are no saving and credit coops established by philanthropists except Self-Help Women Saving and Credit Coops and Union. All other saving and credits coops have been established by employees with in the premises of their employers. These coops could allow

only fellow employees as members. Employers provide office facilities free of rent to the cooperatives.

6. The government has not given any land to saving and credit coop so far but consumer coops are going to be given in the near future.
7. The government is not willing to allow the establishment of Coop Banks since such would lead to the removal of large funds from the government owned commercial bank.

#### **F. Interview with Consumer Cooperative Union Officers, Addis Ababa**

**Fikre Mekuria and Tewodros Taddele, ‘Interview with Board Chairperson and General Manager, Mierab Kolfe Consumer Cooperatives Union Ltd’,(5 August 2014)**

1. The purpose of cooperatives has shown change depending on the state economic and political objectives. The Ethiopian imperial regime had an economic objective of increasing agricultural output. Hence cooperatives that used to receive state assistance were agricultural cooperatives. They were intended to be used as a medium of agricultural technology transfer. The Swedish government was giving financial support to such state project. Although there were consumer cooperatives at the time they did not receive state support. The socialist government implemented cooperatives to distribute industrial goods to peasants and as a means of collective farming. The incumbent government has been using cooperatives as an instrument of price stabilization. The government has begun to give emphasis to consumer cooperatives since 2007 when the then Prime Minister declared in public meeting to use cooperatives as a means to fight inflation.
2. Ethiopian Cooperatives have already gone out of the truck of true cooperatives. This is because the government has appealed to cooperatives to get assistance to control inflation. As a result they are not autonomous. They are rather government instruments and are strictly controlled and supervised by the government. Only Unions are a bit closer to true cooperatives. Primary

cooperatives are expected to provide their goods/services to everybody in demand. Unions are also expected to sell to retail traders.

1. Cooperatives are given special privileges. All the transactions of cooperative union are free from value added tax. There is no income tax. Lease price free land has been given to all consumer cooperative unions in Addis Ababa. Consumer Cooperatives are entitled to loan from government with out collateral.
2. There is a hope that once the government puts inflation under control it would give consumer cooperatives their autonomy to function in accordance of the principles of true cooperatives.
3. There are ten consumer cooperative unions in Addis Ababa, one at each sub-city. There is a plan to establish Consumer Cooperative Federation in Addis Ababa..
4. Consumer cooperative unions distribute their profits annually on the basis of 60% transaction and 40% share capital.
5. There are profits maximizing cooperatives which are not willing to be bound by cooperative principles.
6. Cooperatives are now gaining property and to ensure such property against risk they need insurance cooperatives. However; the Ethiopian Insurance regulation restricts insurance business to share company form. As a result cooperatives are forced to establish a micro Insurance company under the Commercial Code of Ethiopia that operates outside of the real of cooperative principles. Cooperatives have also established Bank in the form of Share Company. The cooperatives are establishing such companies not because they are profit motivated but because there is no room in the law that allows them to establish cooperative bank and cooperative insurance.
7. The government controls cooperatives. To start with the cooperatives depend on the model bylaw prepared by the government. In addition through inspection and audit process the government controls sale price, market coordination, membership, capital increment, and loss. It also controls that the cooperatives are supplying goods to the public without discrimination.

**G. Interview with Ethiopian Central Statistics Authority Officer, Addis Ababa**

**Zelalem Hailegiorgis, ‘Interview with Business Statistics Director Directorate Director’ (3 August 2014)**

The interview I made with Zelalem was short .I asked him whether there is any data on cooperatives in Ethiopian Central Statistics Agency. He said there has not been any data. He continued to explain why they do not have such data. He said that the Authority collects data on those entities that can have an impact on the national economy either as a GDP contributor or monopolized sector. He continued and said that the role of cooperatives in this respect has not yet felt by the economy.