

## Research Paper

The Role of Cooperatives in the development of Agriculture in  
Armenia, Asian Countries & EU (Worldwide case studies)

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## **Abstract**

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The agricultural sector accounts for around 21 per cent of Armenia's GDP (National Statistical Service of Armenia, 2012) and is one of the main pillars of the country's economy.

Since the breakup of the Soviet Union and the privatisation of land, a few agricultural cooperatives were formed in Armenia; however the practice has not been largely successful. This is in part due to the psychological resistance coming from individual farmers, who are oblivious to the advantages of being organized in cooperatives. The supportive legal and economic policies are the prerequisites for the sustainable development of cooperatives in Armenia.

The research paper aims to demonstrate the potential role cooperatives can play in the development of agriculture in Armenia.

The recommendations are proposed based on the studies conducted in European and Asian countries, by International Cooperative Alliance (ICA), International Labor Organization (ILO), ICARE, and are based on UN guidelines and recommendations, and European leading research institutions' findings. A study of Ukrainian milk cooperative will also be used in the report to draw parallels, as both Armenia and Ukraine have historical similarities and the predominant agrarian sector.

## Introduction

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Since the early 1800's, cooperatives have made pivotal contributions to the development of economies at strategically important times. In the English-speaking world, the Rochdale Society of Weavers, inspired by ideas of Robert Owen and William King, is considered the first cooperative documented in 1844 in Rochdale, England (OCDC 2010, 36).

In 1995, the ICA restated, expanded and adopted the 1966 principles to guide cooperative organizations into the 21st Century, which were based on guidelines written by the founders of the modern cooperative movement in England in 1844. These guidelines of cooperatives are: (1) Voluntary and open membership: (2) Democratic member control: (3) Member economic participation: (4) Autonomy and independence: (5) Education, training, and information: (6) Cooperation among cooperatives: (7) Concern for community (ICA, 2012). These guidelines are explained in detail in the appendix.

During the Soviet times in Armenia, the norms and volumes of production were set by governmental planning agencies and implemented by collective enterprises, such as sovkhozes and kolkhozes.

After the collapse of the Soviet Union in 1991 and the privatization of land and main means of production, each farmer received on average 1.4 ha of land. Lack of necessary bargaining power resulted in weak relationships with the processors and other actors in the value chain (Vardanyan 2012, 3).

The cooperative movement started to emerge in Armenia in 1993. The United Methodist Committee on Relief (UMCOR) NGO in the framework of its Community Association Project (CAP) provided assistance to seven rural communities of establishing cooperatives in Ararat and Vayots Dzor Marzes. (UMCOR, 1994-2007)

In 1999, the USDA Marketing Assistance Program (MAP) formed the "Lejan Milk Producers Association" consumer cooperative in Lejan Village of Lori Marz. Following these developments, several individual farmers began establishing their own cooperative enterprises.

As a result, prior to 1999 there have been 297 registered consumer cooperatives in Armenia. As of September 2011, 239 cooperatives were registered, of which 118 were agricultural ones. Thus, almost 50 percent of the cooperatives in Armenia operate in the agricultural sphere (Urutyanyan, 2012: 6).

## **Current state of agriculture in Armenia**

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Agriculture is the biggest employer in Armenia. Being a post-Soviet nation, Armenia greatly depends on agriculture. In 2011 the share of agriculture in the GDP comprised 21% (National Statistical Service of Armenia 2011).

About 46% of employment in Armenia and about 60% of income in rural areas was due to the agricultural sector for the past five years. The local demand for plants, potatoes, main fruits, grapes, and veal is 98% satisfied by the local production, whereas the self-sufficiency level is quite low for wheat (40%), other grains (50-55%), poultry (15-17%), and pork (50-55%) (Vardanyan, 2012:5).

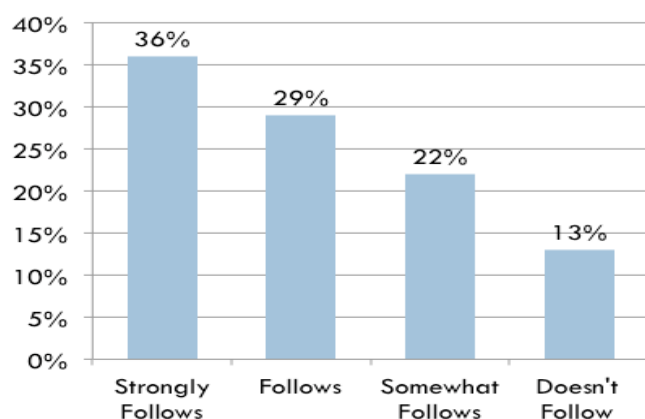
Since the Republic of Armenia is on a long way of recovery from the negative consequences of the financial crisis, and considering the high contribution of agriculture to the country's GDP, the role of agricultural cooperatives becomes more critical in this continuous improvement process. Today people in rural areas do not have necessary funding to acquire consumer services, such as housing, education, social benefits, telecommunication, credit, and other financial services. In this context, agricultural cooperatives, as a major component of the food and agriculture industry, can help them to market their products and secure the supplies they need at competitive prices.

## Methodology and Data Analysis

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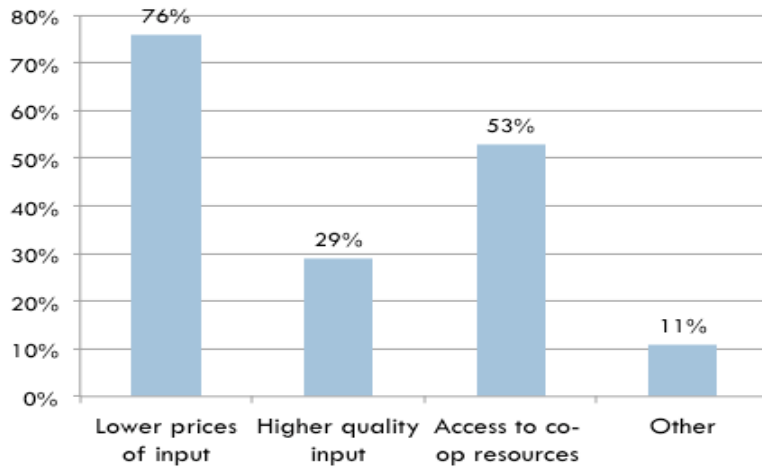
The survey conducted by Tatevik Avetisyan in 2012, has revealed the economic impact of cooperatives on members, who were involved in most activities of cooperatives. The importance of this study is the first-hand experience through personal interviews with members of cooperatives. The survey was conducted in ten cooperatives of Ararat and Armavir Marzes. Five members on average were surveyed from each farm supply or service cooperative. For purposes of analysis in this study, farm supply and service cooperatives are combined into a single group.

The data analysis section represents the results of the abovementioned survey. It demonstrates the decisive factors for becoming a member of a cooperative.



**Figure 1.1: “How closely does the cooperative follow "member economic participation” principle”?**  
(Source: Avetisyan, 2012)

Figure 1.1 demonstrates that 36% of respondents strongly follow the member economic participation principle, 29% follow, 22% somewhat follow, 13% do not follow. The “member economic participation” principle implies the creation of common equity of the cooperative through membership fee. Therefore, the low rate of member economic participation may result from either lack of financial resources or the imperfect legal definition of ownership rights in the cooperative.



**Figure 1.2: Reasons for joining the cooperatives (Source: Avetisyan, 2012)**

Figure 1.2 demonstrates that the majority of farmers (76%) value lower input prices, as the most attractive factor when joining a cooperative. 53% of farmers found the access to cooperative’s resources as a valuable factor, such as knowledge sharing, common machinery usage, financial and other resources.

An important aspect for members is the ability to borrow money with very low risk and 0% interest rate. All of the surveyed cooperatives acquired financial resources without collateral and other expenses. The Federation of Agricultural Associations Union of Legal Entities (FAA) provided necessary input to member farmers based on the type of each estimated input. Acquisition of financial resources without collateral and other expenses was done through all of the surveyed cooperatives. The members would return the money at harvest time, within the six-month period.

On the other hand, 53% of the respondents indicated they joined their cooperative in order to have access to cooperative resources on better terms. In 2010 UMCOR, in cooperation with CARD, provided cooperatives with agricultural machinery (tractors) and equipment for common usage. A schedule was designed for members to use the tractor paying some fee for the service, which mainly included the cost of petroleum and tractor driver’s payment in proportion to their land size. This particular service costs members of cooperatives 20% less on average compared to the market price for non-members.

## **Legislative regulations of cooperatives in Armenia**

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The obstacles hindering the further development of cooperatives in Armenia include the lack of comprehensive legislation for cooperatives. The existing legal framework in Armenia is poorly designed.

According to specialists of the International Co-operative Alliance (ICA), having one general law on cooperatives best guarantees the autonomy of cooperatives and diminishes the bureaucracy. The cooperative sector in Armenia is regulated by the Law on Consumer Cooperation adopted in 1993 and corresponding articles of the RA Civil Code (Articles 117 - 121), which do not properly regulate the registration and dissolution of cooperatives in Armenia.

Availability of a regulative law on cooperatives, in addition to dissemination of the understanding of the cooperative concept, would significantly boost the cooperative movement in the country.

The studies conducted by Vardan Urutyun in 2012 recommend implementing legal reforms through registration, membership, funding, taxation and monitoring processes of cooperatives in Armenia.

### **The registration of cooperatives**

Many countries do not have registration fees or other duties imposed on cooperatives. In Armenia EUR 20 is charged for registration and EUR 10 for change in the number of cooperative's members. Change refers to the registration of each new member; thus, it results in EUR 10 membership fee. This burden forces cooperative not to register their members.

### **Members of cooperatives**

The main purpose of each cooperative is to meet the needs of its members. The cooperatives may achieve increased economies of scale and savings by selling goods and services also to non-members. The solution to financial problem of cooperatives is the amendment of provision in the law to enable the investor-members to participate in the management of cooperative. Failure to use the coop over a certain period should imply the dismissal of the member in question from the cooperative.



### **Cooperative funds**

According to Article 118 of the RA Civil Code, a cooperative may have an indivisible fund. The law shall reinforce the creation of indivisible funds, as an assurance for the stability of cooperatives and means to cover the cooperatives' losses.

In Italy 30% of gross revenues constitutes as indivisible funds, and following the termination of cooperative these funds are transferred to the cooperative federation. Afterwards, the cooperative federation is obliged to create or promote new cooperatives. The most applicable suggestion for Armenia is to follow the Poland's experience and allocate 5% of the annual profit for the creation of indivisible funds, until it reaches the statutory capital.

### **Monitoring of cooperatives**

In Serbia, Poland and Denmark the unions of cooperatives implement the audit of cooperatives. Considering the development patterns of cooperatives in Armenia, the annual monitoring should be obligatory to assure cooperatives follow the principles and operate transparently. Meantime, the monitoring should have an advisory role, instead of imposing fines and penalties.

### **Case study of Ukrainian milk cooperative**

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A case study has been done in another post-Soviet country, the Ukraine, showing the positive impact of creating a cooperative of dairy farmers.

In 2011, the Milkland Group supported the establishment of 16 milk cooperatives, as unions of individual dairy farmers, in Ukraine. These cooperatives provided benefits to both individual farmers and member-households. The high-quality milk and increasing productivity were the prerequisites of increased sales and enhanced customer loyalty. During four months, the production volume of these cooperatives enabled to supply more than 15% of the Milkland Group's total milk collection in Ukraine. Moreover, the program has attracted 16,000 individual members and 19,000 milking cows.

The experience of the Ukrainian milk cooperatives provides significant benefits for the Armenian dairy sector:

- investment into milking equipment,
- centralized veterinary services,
- higher milk volume, better milk pricing and improved quality,
- modern technologies of cows feed and care.

The case study suggests the need for the Armenian private sector to collaborate with International donor organizations and create Farmer Communities. Collaboration among different farmer groups in villages of Armenia will enable them to achieve the economies of scale, easily adapt the modern equipment and knowledge into rural areas and improve the quality of produce to generally accepted EU standards.

## **Partnership with Cooperatives**

The system of public procurement can be the fuel enhancing the cooperative efficiency. One of the examples is so called ‘special clause’ which, in Italy, provides social enterprises with a certain form of positive discrimination in tender procedures. This same clause guarantees social companies that some activities, such as certain services can be awarded by local self-governments to socially responsible firms or cooperatives towards solving community problems.

International experience shows that constructive partnership between Government and cooperatives is possible and can be established. In the spheres where Government provides social support to vulnerable groups, cooperatives can play a significant role. One of the examples of such partnership was established in the south of Serbia, where the local municipality found interesting solution, when providing the vulnerable groups with food. Municipality encouraged a creation of local cooperative, by providing them with an agricultural land and guaranteeing to procure the harvest from them, which was being used to provide social assistance to people in need.

### **Case 1: “Zero Hunger” program as a pillar for cooperative development in Brazil**

The program "Zero hunger" was launched in Brazil in the early 21st century by UN agency FAO (the Food and Agriculture Organization). It provides an example of a classical governmental support model for cooperative development. During the program free school meals for over 4 million people in 780,000 families from 837 municipalities needed to be distributed. Fresh and cooked food for the poorest was to be provided through the school lunch service and a shared kitchen. Upon the decision the food was bought from local farmers, mainly through agricultural cooperatives or associations. Buying from local producers also meant better transport and other communication links. Program so far achieved remarkable success, rapidly achieving the basic goals. Argentina, Peru and Venezuela have recently started similar programs to establish community-owned restaurants and dining programs in schools designed to enable local procurement as a way out of poverty and underdevelopment.

## **International Experience in Developing Cooperative Legislation**

The main intent of any cooperative legislation should be to provide the framework within which cooperatives can carry out their purpose of providing benefits to members. On one hand the law needs to be positive and enabling, but at the same time it should emphasize the self-governing nature of cooperatives. It can be dangerous to enact and implement laws that are too detailed, as this tends to lead to a high level of state interference in the affairs of cooperatives. The task of designing a legal framework for cooperatives should proceed from the premise that as many decisions as possible should be left to the members of each individual cooperative. Those involved with cooperatives in Denmark are often pointing out that they do not have the benefit of any separate legislation for cooperatives, and that their requirements are adequately covered by the general laws. At the other end of the legislative spectrum is the United States that provides numerous legislation covering every angle of cooperative administration and activities. However, the cooperative legislation of most countries fits somewhere between these two extremes.

Cooperative legislation can be found mainly in two forms:

- A general cooperatives law that regulates all types of cooperatives in a country; this is the most common form of cooperative legislation and can be found, for example, in Brazil, Serbia, Germany, Hungary, India (both at federal and at state levels), Jordan, Kenya, Mexico, Spain and Thailand.
- Separate laws for special types of cooperatives; some countries, e.g. Ethiopia, Japan, Romania, Uruguay and others, have adopted specific laws for different cooperative sectors.

In this section we will explore the legal structures of Asian and European countries, investigate the recommendations on cooperative laws of ICA, ILO and UN, and take a close look to the

developments in Serbia.

## **Cooperative Legislation in Asian Countries**

In the second half of the 19th century in several Asian countries, particularly in Japan, India, Indonesia attempts were initiated to organize cooperatives and conduct social reforms. Most of the Asian countries were under colonial regime and were forced to implement the laws dictated by the rulers. Thus in the first half of the 20th century colonial governments in most countries in Asia tried to control local cooperative leadership and people. The situation changed considerably in the second half of the 20th century when most countries got freedom and national governments took over. Practically in all countries cooperatives were considered as an instrument of bringing socio-economic development and particularly agricultural production and rural development. Governments provided liberal financial assistance and support to development of the cooperatives. From Asian countries Japan was the first country to initiate a cooperative law in 1900. Based on the German law, it was later amalgamated and replaced by the Agricultural Cooperative Law in 1947<sup>1</sup>.

In Asian countries currently two types of cooperative laws are prevailing: common cooperative law, and sectorial laws. With the exception of Japan and South Korea in all Asian Countries there is one common law for all types of cooperatives. In Japan and South Korea different laws regulate the different types of cooperatives.

The **objective** of the laws is similar across the countries, however, we underlined the objective of Japan's law, which is worded very clearly and specified the support and assistance to cooperatives. Article 1 of the Agricultural Cooperative Society law of Japan states the objective of the law as: "This Law has for its objectives the promotion of sound development of farmers' cooperative system, thereby improving agricultural productivity and socio-economic status of farmers, as well as ensuring the development of the national economy".

Examining the cooperative principles mentioned in the laws of Japan, India, Philippines, Malaysia, Indonesia, Sri Lanka and others, we can state that the principles are in accordance with

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<sup>1</sup> A Study of Cooperative Legislation in Selected Asian and Pacific Countries, FAO

ICA cooperative principles or at least not contradicting them.

Every cooperative society before it starts functioning must get itself registered under the cooperatives law. Most countries have time limits for registration. At present it ranges from 30 days (Philippines) and 2 months (Japan) to six months (India and Indonesia), while some countries have no time limit (Bangladesh, Malaysia, Nepal, Sri Lanka, Thailand). Fiji's case is interesting to examine, by which the registering authority in cases of doubt is permitted to issue provisional registration for a maximum period of two years, during which the performance of the cooperative is assessed. If a society fails to perform in a satisfactory manner its provisional registration is cancelled. Basically the registration authorities take into account two main issues:

- that the application and bye-laws are in conformity with the cooperative laws and the cooperative identification statement, and;
- that the members are capable of using the services rendered by the proposed cooperative.

Many countries specify that in cooperative there can be associate members who can also use the services of cooperative but are non-shareholders and non-voting members can be asked to pay membership fee. One important issue in Korean and Japanese laws is worth noting: when a member has failed to utilize the cooperative for a period of more than one year, he could be expelled. Also when he fails to comply with obligations such as payment of investment, sharing of expenses or any other obligation to the cooperative, he can be expelled. This is an important issue assuring that members are the users of the cooperative. The principle should be **“no use of service- no participation in the management”**. Also provision in the laws should state that if a cooperative fails to maintain a certain level of its business with cooperatives members, it should cease to be treated as a cooperative<sup>2</sup>.

Cooperative management can be classified by five elements, namely Annual General Assembly (AGA), Board Chairman, Chief Executive, Audit and Committees (in some countries). In cooperatives the General Assembly is the supreme body. A General Assembly must be called at least once a year, and its power and functions are mostly uniform across the countries.

In some Asian countries the law requires audit to be done by the Government Department, either by Department Auditors or by qualified auditors appointed by the Department (as in Bangladesh, India, Nepal, Fiji, Thailand, and Sri Lanka). In other countries, an audit committee or auditors are appointed by the General Assembly or by Cooperative Union, (as in Korea, Japan, Philippines, Malaysia, and Indonesia).

Cooperative is encouraged to create funds for various purposes. Creation of a reserve fund is

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<sup>2</sup> A Study of Cooperative Legislation in Selected Asian and Pacific Countries, FAO

obligatory practically under all laws. Some laws (i.e. Indonesian Cooperative Law) require that separate funds are made from cooperative profits from members and non-members respectively.

Facilitations of cooperative activities as mentioned in the cooperative laws are:

**India:** The cooperative capital share, contribution, or interest of a member, including Reserve Funds, cannot be attached to or sold by any court. (Section 54)

**Sri Lanka:** Under Article 35 cooperatives are exempted from payment of stamp duty, registration fee and some other Government fees.

**Japan:** The Government may subsidize part of the expenditures of the unions required for carrying their business within the budgetary limit of each financial year (Article 73.8).

It can be seen that most laws provide concessions, facilities and tax exemptions and financial support to the cooperatives.

### **Cooperative Legislation in European Countries**

Cooperative firms and social enterprises can, despite their differences, be interpreted in a united way as socially-oriented firms: they are entrepreneurial organizations that do not have as their main objective the maximization of private returns (net surpluses or profits) accruing to the investment of capital. Rather, cooperative firms are mutual-benefit organizations that are usually controlled on an equal voting rights basis not by investors, but by different types of patrons (eg. producers, workers, consumers) or by a mix of them (multi-stakeholder cooperatives).

They are created to protect first and foremost their members through the satisfaction of their needs, which can be private or social in nature. Social enterprises, as defined by the UK law on the Community Interest Company in 2005, and by the Italian law on the Impresa Sociale in 2006, are public-benefit organizations that pursue the satisfaction of social needs through the imposition of at least a partial non-profit constraint and by devoting the majority of their positive residuals and patrimony to socially-oriented activities.

The majority of EU countries have general laws on cooperatives. There are countries where the general law is the only existent cooperative law (Germany; Slovakia; Slovenia) and others where, in addition to the general law, there are other special laws (or special rules) on particular types of cooperatives. There are partially different views of the cooperative phenomenon, according to the different manners in which the financial aspect and the social aspect are combined in a cooperative law. In other cases, the social aspect plays a more significant role and

the cooperative is obliged to take into account interests of its actual members.

For better understanding the possible effects of the legal reforms in the Armenian cooperative sector we underlined the important provisions from the cooperative laws of European Union. Austrian cooperatives are permitted to distribute profits and assets to members, and are not obliged to establish reserves and are subject to cooperative revision by auditing cooperative associations, of which it must be a member (compulsory membership)<sup>3</sup>.

Germany is a country where cooperative legislation has a long tradition. It has a detailed and complicated general law and no special laws on particular types of cooperatives exist. Tax law awards a specific treatment of cooperative refunds, on the condition that the income (distributed by way of cooperative refund) is earned in transactions with members, members are treated equally, and amounts are paid out to members<sup>4</sup>.

Hungary has a general law on cooperatives and other special laws on particular types of cooperatives (banking, housing). The general law is a modern and detailed law on cooperatives. It also contains particular rules on social cooperatives. Cooperatives are allowed to admit investor-members to a limited extent. Specific tax treatment only applies to surplus allocated to the reserve fund<sup>5</sup>.

Portugal has 12 different types of cooperatives defined in the Cooperative Code. In addition, Portugal has one special tax law for cooperatives.

Slovenia has a general law on cooperatives and no special laws on particular types of cooperatives. The general law contains several innovative solutions, while still preserving the specific identity of cooperatives. Activity with non-members is allowed, but only to the extent to which it does not render secondary the activity with members. The law requires the establishment of a reserve fund, which may not be distributed during the existence of the cooperative.

There are partially different views of the cooperative phenomenon, according to the different manners in which the financial aspect and the social aspect are combined in a cooperative law. In

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<sup>3</sup> ICA, The Austrian cooperative law in a changing world of times, framework since 1873, European research conference, Lion

<sup>4</sup> Cooperative Society Act, 1973

<sup>5</sup> <http://www.ilo.org/public/english/employment/ent/papers/favclim.htm>

some cases, the financial aspect is predominant; therefore, the cooperative may freely distribute profits in proportion to the paid-up capital; devolve assets to members in case of dissolution etc. normally, in this case, cooperatives are not subject to a specific tax treatment;

In other cases, the social aspect plays a more significant role and the cooperative is obliged to take into account either interests other than those of its actual members (the interests of its subsequent members, other cooperatives, the overall cooperative movement, the community) or non-financial interests of its members (e.g., their education) normally, in this case, cooperatives are awarded a specific tax treatment and are subject to a specific form of control (however, this is also provided for in legislation following the first, above mentioned, view);

There are traditional (e.g. Polish) and innovative laws (e.g. Italian, Norwegian) to the extent to which they try to adapt traditional cooperative principles to specific (mainly financial) needs of the cooperatives<sup>6</sup>.

Italy has a strong and developed cooperative sector. Cooperatives are successfully operating in almost any sphere of the economy, competing with other firms and organizing cooperative mergers. The developed cooperative movements are to big extend due to the innovative and favourable legislation putting much attention on the social functions of cooperatives. A cooperative, according to Italian legislation, is distinguished from other enterprises by the fact of the combination of economic and social aspects, as clearly stated in the Italian Constitution, which specifically ascribes a social function to cooperatives.

Italian legislation differentiated two types of cooperatives: Mainly mutual and Other type.

Mainly mutual cooperatives are characterized by two elements: they must operate predominantly with their members and they can remunerate the capital subscribed by members only to a certain extent. Mainly mutual cooperatives are subject to tax benefits.

Other cooperatives are not subject to these restraints: they can freely operate with non-members and they can freely remunerate the capital. Nonetheless, they remain “cooperatives”, although, being “Other”, they are not eligible for tax benefits (as they are eligible for other benefits).

Italian law obliges cooperatives to contribute 30% of total annual profits for the legal reserve, regardless of the amount of the legal reserve. The compulsory contribution to reserves is a solution to the undercapitalization problem in line with cooperative principles, as it reinforces the

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<sup>6</sup> Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society, Euricse, 2010



non-distribution constraint and the solidarity aspect of a cooperative (solidarity among co-operators, from old co-operators toward new co-operators).

In addition, according to Italian law, cooperatives are obliged to allocate 3% of total annual profits to the mutual funds for the promotion and development of cooperation with the aim of promoting and financing the development of new cooperatives in various manners. In the event of dissolution of the cooperative enterprise, its assets have to be allocated to these funds, designed to promote to newly established cooperatives.

### **Cooperative Sector of Serbia: Developments and Legislative Innovations**

The idea of cooperatives was present for many centuries in Serbia. Serbia has interesting and rich history of cooperatives, and its experience can be very useful in designing Armenian cooperative policy and legislation because of two reasons. First, Serbia also was a socialistic country not very long time ago, and farmers of Serbia also experienced the socialist forms of cooperatives, which currently are associated with bad memories of that time, case which is prevalent in Armenia as well. Second, Serbia is a developing country, having several economic indicators which are comparable to Armenian indicators, creating common similarities.

Meanwhile Serbia is a country which has a long dating cooperative history, coming from 19th century. Kingdom of Serbia was one of the twelve countries that in 1895th founded the International Cooperative Alliance (ICA), an international representative body of cooperative movement, today representing the largest non-governmental body in the world. The study therefore concludes that there is a tradition of cooperatives in Serbia, which provides opportunities for further development and could serve as a benchmark for policy development in Armenia. Among the major actions in the cooperative field of Serbia, is the introduction of a new Draft Law on Cooperatives, which contains number of innovative solutions against current challenges in the country. One of the innovations in the law is inclusion of special provisions on Social Cooperative as a legal form, which we will later discuss in a separate section.

The first law that expressly dealt with cooperatives in Serbia was the Law on Agricultural and Handicraft Cooperatives of 1898. In the law such important provisions were prescribed as minimum number of members (10), voluntariness and democratic principles, management mechanisms etc. Besides, the Law regulated the issue of cooperative unions. Alongside with political regimes and transformations, the law on cooperatives experienced number of adjustments. After the Second World War a socialist type law on cooperatives was enacted, that

was basically a framework law, whereas detailed rules were provided in lower legal acts. This Law was a good example of how can very general, framework laws open doors for manipulations through lower level legal acts<sup>7</sup>.

In fact, currently there are two laws in force that regulate the same subject matter in Serbia. One was “inherited” from the Federative Republic of Yugoslavia; and now published in Official Herald of the Republic of Serbia (2005, 06). The other is the so-called “republican” level law, the Law on Cooperatives published in the Official Gazette of the Republic of Serbia (1989, 93, 95, 2005).

Although the current situation is not satisfactory to the stakeholders, however, recent developments, some governmental support to social cooperatives<sup>8</sup> and expected adoption of a new innovative law on cooperatives are expected to have their significant effects in the field and contribute to the cooperative prosperity in the country. The proposal of the new draft law on cooperatives was highly initiated and supported by local NGOs (Grupa 484, Secons etc). In the new law several innovative provisions are presented, officially recognizing social cooperatives as a legal entity, regulating the functions of cooperative alliances and cooperative properties.

Cooperatives are legal forms with more mutual characteristics with social entrepreneurships than any other forms of enterprise. This is due to the following reasons: 1) historically, cooperative is a legal form that enables people to organize themselves in accordance with the principles of democracy, equal share and joint distribution of profit; 2) sociologically, principles of cooperatives correspond to the principles of solidarity and inclusiveness which are also the basis for social entrepreneurship; 3) economically, cooperatives have directed distribution of profit, which is also significant for the social enterprises.

In most European countries, roots of social entrepreneurship are based in the enterprises for professional integration of persons with disabilities. The very concept of social economy and social entrepreneurship started developing on the foundation of Italian social cooperatives that were established as a result of the reform of the health protection system, primarily related to treatment of persons with psychological difficulties.

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<sup>7</sup> Z. Vig, A. Olenik, Analysis of Legislative Framework on Cooperatives in Serbia

<sup>8</sup> Although the term social cooperative is not officially recognized yet, there are cooperatives which are operating based on their principles.

Therefore, it is not surprising that the first social enterprises, in mid-seventies in Italy, functioned using the form of cooperatives, and that the first law which introduced the discussion on social entrepreneurship in Europe, was Italian Law on Social Cooperatives from 1991.

This initiated adoption of similar laws in other countries, and in 1997 Portugal adopted the law on “cooperatives of social solidarity”; in 1999 Spain adopted the law on "cooperatives for social initiative "; in 1999 Greece adopted the law "social cooperatives with limited liability ", and in 2002 France defined "cooperative companies with collective interest ".

Apparently, Serbia is also following this trend of introduction of social cooperatives in the legal system. Namely, proposed Draft Law on Cooperatives introduces social cooperatives into the legal system.

Movements towards social entrepreneurship, being emerged from European Union, particularly from Italy, have reached to Serbia, where already we can find entities operating practically on the same principles. One of the examples of such organizations is waste collection cooperative SWIFT, operating in Belgrade. The cooperative is basically operating on the principles of social cooperatives, however, as currently the term social cooperative is not officially recognized, until the adoption of a new law, the organization is registered as a consumer cooperative. SWIFT cooperative was initiated and developed by WHO (World Health Organization) and is implemented by UN partners (UNOPS and IOM) in collaboration with governmental bodies and achieved efficiency in its first year of operation.

### **Cooperatives in Serbia**

In Serbia there are about 2200 cooperatives (according to the data of 2009) among which the largest share, about 70%, constitute to farmers. Currently there are ten cooperative unions registered in the country, with the roof organization of Cooperative Union of Serbia, established in 1895.

In the new Draft Law on Cooperatives there were number of amendments and new concepts that will definitely provide the stakeholders with supportive mechanisms.

Article 11 of the proposed Draft Law on Cooperatives introduces and defines the term social cooperatives. The following four paragraphs of above-mentioned article are dedicated to defining the form of social cooperatives:

- Social cooperatives perform different activities in order to achieve social, economic and work inclusion, as well as in order to fulfil other related needs of members of vulnerable social

groups.

- Social cooperatives are under obligation to invest portion of its profit in improvement of health and social insurance, employment, social, economic and work inclusion, work conditions, work skills, standard of living and satisfying the need of the members of vulnerable social groups.
- In the context of this new law, members of vulnerable social groups are persons who belong to social groups with social needs, according to the law which regulates social protection and social safety of citizens.

The most important provisions in the law are the followings:

### **The concept, form, activities and types of cooperatives**

A cooperative is a legal entity that stands for a special form of organization of natural persons (hereinafter: cooperative members) who, by carrying out business activities on cooperative principles, realize their economic, social and cultural interests, and control the cooperative in a democratic manner.

Upon its activities the cooperative should chose the most appropriate type constituting its operations. The main activity of a cooperative defines the type of cooperative. The main activity is the one which was designated as such by the Foundation Act and enlisted in the Registry: Agricultural, housing, youth, craft, consumer, social, student. Cooperatives can carry out other activities in accordance with law.

### **Foundation of cooperatives**

Cooperatives can be founded by at least with ten individuals. A cooperative is established at a Founding Assembly session, with the adoption of founding act and the rules of cooperatives. A cooperative's Foundation Act shall be its founding contract, concluded in the written form.

### **Membership of a cooperative**

A cooperative founder shall not have special or greater rights and responsibilities in comparison to other cooperative members. The decision on joining the cooperative shall be made by the cooperative's Steering Committee. The amount of membership fee shall be established by the cooperative rules, in the amount equal for all founders, as well as for members who have joined the cooperative after it was founded. Cooperative shall be obliged to keep the book of cooperative members.

### **Cooperative management and management bodies**

Cooperative is managed by members of a cooperative by one-member one-vote principle. Mandatory management bodies for each cooperative are Assembly, Steering Committee (at least five members) and Director; in addition a cooperative may have optional Supervisory Board (at least three members). Cooperative Assembly consists of all cooperative members and has the highest authority and can have a representative in case members exceed 100. The Steering Committee shall have a Chair, who shall be appointed by the members of the Steering Committee, by a majority of votes of the total number of members. The Cooperative Director, the Chair of the Assembly and the Supervisory Board members may not be elected as members of the Steering Committee.

### **Property and business activities of a cooperative**

The property of a cooperative consists of movable and immovable properties, funds, securities and other property rights permitted by the law. The assets of a cooperative are independent from its members. The cooperative is required to keep books and present financial reports. A cooperative member shall be held accountable for the cooperative's obligations up to the amount of his/her investment and guarantee and not with its own property.

### **Distribution of profit and loss coverage**

The distribution of profit is decided by the assembly upon adoption of financial report with the following sequence: first to cover the losses, then, make payments to the reserve funds and distribute the profits to the members according to their contribution. Losses are covered from the reserve funds of a cooperative or from a retained earnings from the previous year. A cooperative may establish a Cooperative Fund which is used for investments.

### **Termination of cooperative**

A cooperative can be terminated if the expiration date is not prolonged by the assembly, by the decision of the assembly, upon change of the status, by bankruptcy as well as by a decision of a competent authority if cooperative doesn't comply with the prescribed acts. The cooperative property that remains after the creditors' claims were paid shall be transferred to the regional cooperative union, which in its turn is obliged to use the property in creation of a new cooperative.

### **Cooperative alliances**

A cooperative alliance is an autonomous and professional organization, which is established with

the purpose to achieve, improve and protect the mutual interests of cooperatives and cooperative members, as well as to advocate for them and create business connections and can be based on territorial and/or vocational basis. The law regulates the foundation of cooperative alliances, their management issues, properties and funds.

### **Case 2: Cooperative Union of Serbia**

The Cooperative Union of Serbia, established in 1985 is a roof organization for 10 cooperative unions, having 1200 member cooperatives, out of which 500 are operating effectively. 95% of cooperatives are agricultural cooperatives and 5% represents craft sector. According to the president, currently there are several challenges, union is faced. Among which are mistreatment of the word “cooperative”, ownership issues, old cooperative problems, financial problems. The mission of the Union is economic and legal assistance to cooperatives and cooperative unions, protection of their rights, advocacy of new policy to the Government. The Union has its role in several cooperative supportive programs, one of which was provision of loan to the cooperatives of Shabats region with loans, interest payments of which was delayed for 5 years, until the cooperatives achieve efficiency.

The Union is a member of ICA, and organizing number of events and conferences promoting cooperative values and principles.

### **Cooperative audit**

Cooperative audit is control of application of cooperative principles and cooperative values in organization and business activities of a cooperative. Cooperatives are obliged to carry out a regular audit. Cooperative audit may be performed by a cooperative alliance that owns a license for performing cooperative audit. The licenses, rights and obligations of the auditors are prescribed in the law. Cooperative audit is mandatory for cooperative alliances as well and should be carried out by another alliance.

### **Penalty provisions**

Cooperatives are subject to penalties from EUR 5,00-30,000 in case they:

- Operate without being enlisted in the registry
- if it does not obey the regulations adopted by the Government
- if it does not undergo the cooperative audit process by its own fault
- if it does not act upon the final audit report.

In addition cooperatives are subject to penalties when in their commercial name they don't mention the term “cooperative” or the name is misleading, if they don't keep books, if they don't provide necessary documents to the auditors etc.

The New Draft Law on Cooperatives is expected to bring number of modifications and

improvements according to a number of experts. The advantages of the new law relative to the old one include replacement of outdated and dis-functional provisions that doesn't comply with current socio-economic conditions, creation of mechanisms of capital attraction, cooperatives are treated as an organizational form (whereas the old law treated them as a business entity), incentives for privatization of inherited property, introduction of a new form: social cooperative, legal regulation of cooperatives audit, which is now regulated by the rules of cooperative unions.

## **The Role of Social Cooperatives in Social Economy Development**

Growing unemployment amongst certain groups, social exclusion from general services, gaps in social protection of people with disabilities or minor groups raised preconditions for new types of enterprises which aim was provision of benefits to its members or larger community, rather than generation of income to investors. Due to their explicit social goals these enterprises got a name of social enterprises, mainly operating in the form of a cooperative or association.

Social enterprise can be defined as an organization that uses business strategy for achieving social goals. They generate their surplus generated as a result of business activities is directed in pursuit of social and environmental purposes.

The OECD defines social enterprises as “any private activity conducted in the public interest, organized with an entrepreneurial strategy but whose main purpose is not the maximization of profit but the attainment of certain economic and social goals, and which has a capacity for bringing innovative solutions to the problems of social exclusion and unemployment”<sup>9</sup>. Others define social enterprise as an enterprise primarily providing employment and social benefits to vulnerable groups and communities.

The main distinguishing characteristics of social enterprises are the combination of entrepreneurial activity, social aim and participatory governance. The recent tendencies, recognizing the importance of social enterprises, show that when an enterprise is qualified as being social it receives some benefits from the government. The qualification requirements are different across countries, however the main features include:

- Activity producing goods and/or selling services

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<sup>9</sup> OECD, 1999

- A degree of autonomy
- A trend toward paid work
- An explicit aim to benefit the community or a specific group of people
- A decision -making power not based on capital ownership
- Exclusion of profit - maximising organizations

In addition, social enterprises should be successful in the market and have positive balance.

Social entrepreneurship and social enterprises appear as appealing approaches for facing new and old social problems and challenges, given the ultimate goal of creating healthy and sustainable communities. These initiatives are mainly described as innovative ways to address issues in a number of domains, including health, social services, education, environment, fair trade, and more generally services for local communities.

The notion of social enterprise was used for the first time in Italy in the early 1990s to name a new journal, edited by a consortium of social cooperatives with the aim of representing and analysing the new entrepreneurial initiatives that had been developing over the previous decade to supply social services and facilitate the work integration of disadvantaged people.

The notion of social enterprise was further consolidated and clarified by the introduction of specific laws, including the law on social co-operatives in Italy in 1991.

Throughout history, the cooperative form has proved to be a flexible business model that has adapted to economic, cultural, and social contexts, and developed in multiple productive and service sectors. Across Europe, over the last three decades, new cooperative forms have emerged in new areas of activity, demonstrating their capacity to adjust to the evolution of needs arising in society.

The European experience shows that in a number of countries social enterprises have developed using the legal form of the cooperative (for example, in Italy through social co-operatives, in Spain through social cooperative societies supplying social services and Labour integration cooperative societies; in France through the sociétés cooperatives d'intérêt générale; and, in Poland through social cooperatives integrating disadvantaged workers).

Based on other countries' experience, a law on social entrepreneurship could represent a unique opportunity to rehabilitate cooperatives and fully exploit their potential as community enterprises.



Generally speaking, social enterprises are likely to work in any field of activity that is of interest to the community as a whole or for specific vulnerable segments of the population.

Work integration constitutes a major sphere of social enterprise activity in Europe. The objective of “work integration social enterprises” is to support disadvantaged, unemployed people, who run the risk of being permanently excluded from the labour market. For this purpose, work integration social enterprises integrate disadvantaged people into work and society through productive activity, thus favouring a more effective allocation of society’s human resources<sup>10</sup>.

In the 1980s, the “new co-operatives” played a decisive role in driving the growth of the social economy. They addressed social services to young people with social problems, the elderly, the disabled, drug addicts and the homeless. Many of these services were initially promoted by associations run by volunteers, but the use of the cooperative form rapidly became widespread, especially for the management of activities aimed at integrating disadvantaged workers into the labour market. After a number of years of unregulated development, in 1991 this new type of cooperative was recognized and given the name of “social cooperative”.

International experience confirms that when addressing such a complex and knotty issue like social exclusion, it is important that policy is coherent and integrated at local, regional, and national levels and government will get a good social and economic return from investment in such a strategy. The history of cooperative movements around the world corroborates the idea that cooperatives have often been an adequate method to overcome economic and social difficulties.

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<sup>10</sup> Borzaga, Gui and Povinelli, 2001

### **Case 3: Success of “SWIFT” Social Cooperative in Serbia**

SWIFT Social Cooperative was initiated by World Health Organization and is implemented by UN partners in collaboration with Serbian governmental bodies in Oct. of 2010. The initiative seeks to enhance healthy livelihoods through the creation of sustainable employment for the informal waste collecting Roma community. Upon its activities the cooperative organizes, collects and pre-treats waste, thereby, offering a basis for sustainable and formal employment. Currently the cooperative has 40 members and 16 employees, with the plan to double the number of workers and open another two branches. From the generated profit significant amount is dedicated to the social problems of community, such as health, education, cultural and other services, then, the remaining part is retained to the reserve fund, and left portion is distributed to the members. The cooperative has partnerships with large companies, to carry out their waste. As a feedback the companies are provided with free cleaning services by the cooperative.

Several interesting examples of social development are prevalent in Serbia. According to the new draft law the common characteristics of Social enterprises are to be defined by the government and later, if any company complies with the standards they should receive some special benefits by the state and receive priorities in the public procurement services.

Tax issues will include benefits on income tax, but there should be limits for preventing misuse and manipulations.

According to the current legislation each company having 20 employees should hire one disable person, or make some contributions to the pensions funds for people with disabilities, otherwise they should buy from the unions of disable people, hereby facilitating their progress.

The logic behind provision of special conditions to social enterprises lays down under the fact that the Government spends money on social purposes and social enterprises should be compensated, as they provide part of the social protection.

To prevent the emergence of “fake” cooperatives, they should be under regular audit supervision.

## Conclusion

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To summarize, cooperatives are slowly making an impact across rural Armenia. Cooperatives have huge potential to become one of the cornerstones in Armenia's agricultural and economic development especially in rural areas where the united force of farmers can change their own lives and the overall livelihood of their community.

However, in Armenia cooperatives as organizational models are not sustainable yet. Most of the members did benefit from developing their individual farms but the idea of cooperative as an entity is not developed properly yet. This derives risks in a sense that, after donor organizations leave, cooperatives are broken since most members are not motivated to stay with the cooperative. The experience of many registered but not functioning cooperatives in Armenia shows this effect.

The first reason is the imperfection of law on cooperatives that would define necessary and sufficient specifics of its operation, as well as provide legal protection both inside the cooperative and in interactions with other stakeholders. This would also protect ownership rights and responsibilities of members as well as enable cooperatives to have diplomatic relations with other legal entities, such as processors.

Second, there have been many cases when local people confused cooperative enterprise with once-prevalent collectives from the Soviet Union time. This caused expectations of waiting for governmental aid. Meanwhile, members did not contribute to the formation of common equity of the cooperative. However, they should be more concentrated on cooperatives' self-help, self-reliance and self-responsibility aspects rather than waiting for the external support.

Moreover, the government should not intervene in creation and governance of cooperatives since it contradicts to the principle of independence. Instead there should be improved partnership relations between cooperatives and all its stakeholders, including the government. In the case of Armenia, the government still has much to do in terms of taking actions in creation of favourable legal and economic environment for development of cooperatives.

## **Recommendations**

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After discussing the role of cooperatives in the development of agriculture, as well as the overall situation of the cooperative industry in Armenia several relevant recommendations are proposed to positively influence the growth and development of cooperatives in Armenia.

First, cooperatives as entities need to have legal protection in terms of concise and detailed specification of roles and responsibilities both among members and other stakeholders. Tax advantages should be specified based on the overall size of the cooperative and the number of members.

Second, special educational programs should be developed specifically and separately for cooperatives' governance bodies and members. Furthermore, those members who are not interested in the specific subject should not attend that training. In this case the capabilities and interest of each member is taken into consideration. Meanwhile, governing bodies should be more specialized.

Lastly, members have to contribute to the common equity of the cooperative in order to stay self-sufficient and viable, even in the absence of outside support by donor organizations.

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# Appendices

**Table 1.1: Internationally recognized 7 principles of Cooperative**

**Source: International Cooperative Alliance (ICA)**

## **Voluntary and Open Membership**

Cooperatives are voluntary organizations; open to all persons able to use their services and willing to accept responsibilities of membership, without gender, social, racial, political, or religious discrimination.

## **Democratic Member Control**

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary (true) cooperatives, members have equal voting rights (one member, one vote), and cooperatives at other levels are organized in a democratic manner.

## **Member Economic Participation**

Members contribute equitably to, and democratically control, the capital of their cooperative. Part of that capital is the common property of the cooperative. Adequate capital is essential to a true business cooperative's success. Members allocate surpluses for any of the following purposes: developing their cooperatives capital, which would be indivisible; and supporting other activities approved by the membership.

## **Autonomy and Independence**

Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

## **Education, Training and Information**

Cooperatives provide education and training for their members, elected representatives, managers and employees so they can contribute effectively to the development of their cooperatives. They inform the public, particularly young people and opinion leaders, about the nature and benefits of cooperation.

## **Cooperation among Cooperatives**

Cooperatives serve their members most effectively and strengthen the 21<sup>st</sup> century Cooperative Movement by working together through local, national, regional and international structures.

## **Concern for Community**

Cooperatives work for the sustainable development of their communities through policies approved by their members.

## **Table 1.2: Cooperative Values**

**Source: International Cooperative Alliance (ICA)**

**Self-help** - In cooperatives, people help each other while helping themselves by working together for mutual benefit.

**Self-responsibility** - Individuals within cooperatives act responsibly and play an active part in the organization including governance.

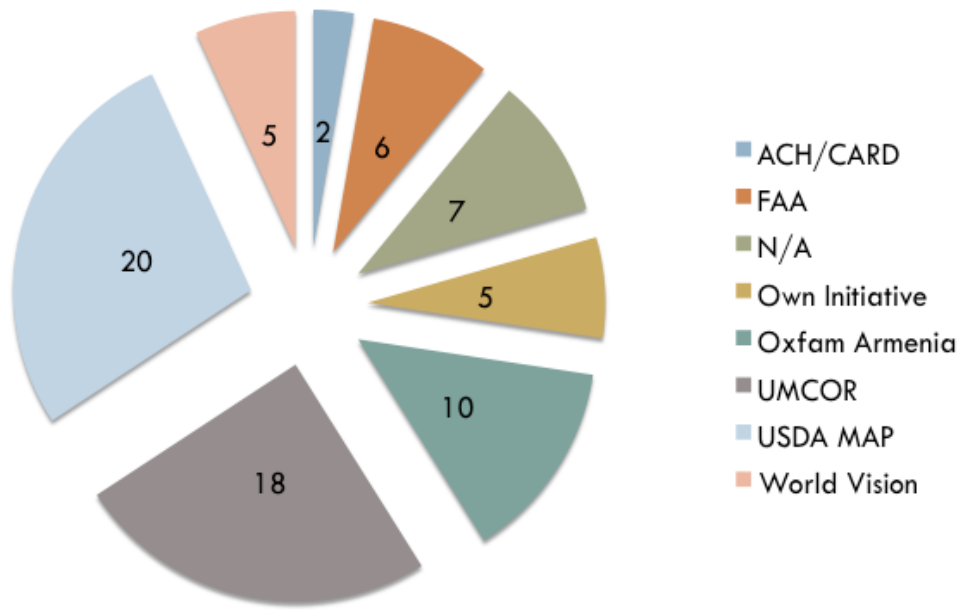
**Democracy** - A cooperative is structured so that members have control over the organization: one member, one vote.

**Equality** - Each member has equal benefits according to their use.

**Equity** – Members are treated justly and fairly.

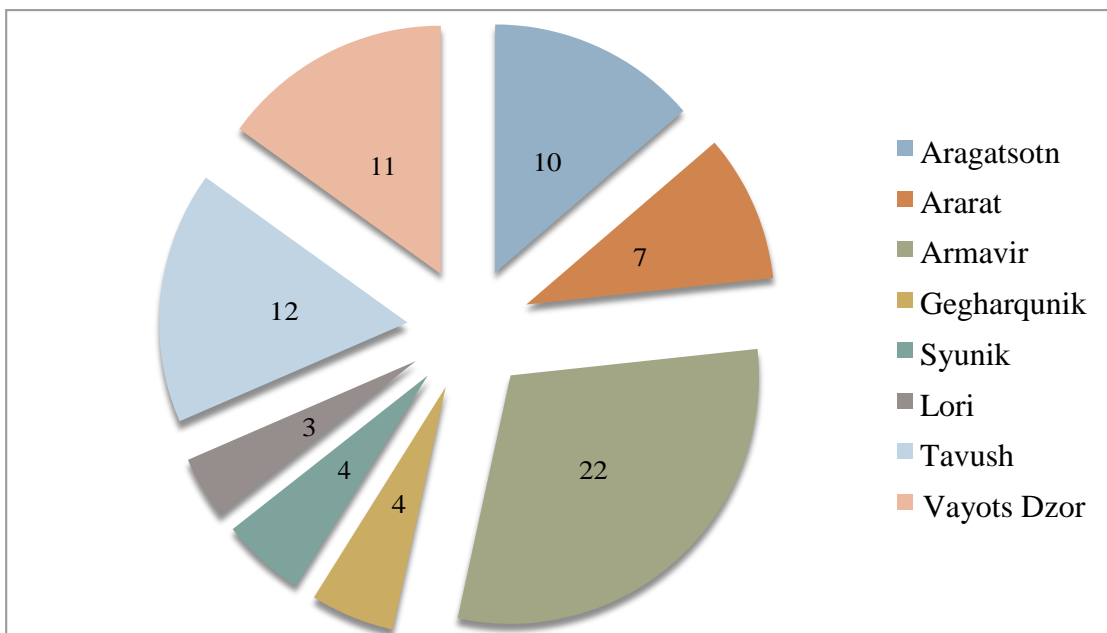
**Solidarity** – Members support each other and other cooperatives.





**Figure 1.3: Consumer cooperatives created by donor organizations**

Source: Urutyanyan, V. (2012) Policies to support small Farmer Organizations in Armenia. pp 9-10



**Figure 1.4: Consumer cooperatives by region**

Source: Urutyanyan, V. (2012) Policies to support small Farmer Organizations in Armenia. pp 9-10