

# Necessity of legal reforms aimed at sustainable development of cooperatives in Armenia

*Vardan Urutyun & Narek Vardanyan*  
*International Center for Agribusiness Research and Education (ICARE)*

## Introduction

Agricultural cooperatives have a long history of success and failures in developing and developed countries. Specialists, officials and other stakeholders in the field have many times emphasized the role of cooperatives in agricultural and rural development. A large number of international and national programs and measures taken have been focusing on the stimulation of the development of cooperatives in Armenia. Nonetheless, cooperatives remain underdeveloped and are far from being a part of the overall agricultural value chains. The reasons preventing cooperatives from success are versatile; however, they may be observed in legal, economic, informational, and sometimes in social-psychological dimensions.

This article considers the necessity of a number of reforms aimed at the sustainable development of cooperatives, based on the experience of European and Asian countries as well as on the results of research and recommendations by the International Co-operative Alliance, International Labour Organization, UN, FAO, EURICSE and many other organizations.

Prior to 1999, 297 consumer cooperatives were registered in the RA. As of September 2011, 239 were reregistered, of which 118 had mentioned in their re-registration documents about their agricultural orientation. Thus, we can state that 239 consumer cooperatives are registered in the RA, 50 percent of which are active in agriculture. It is difficult to say though, how many of them are actually operating<sup>1</sup>.

Currently, the cooperative sector in Armenia is regulated by five articles of the RA Civil Code (Articles 117 through 121) and by the law on consumer cooperation adopted in 1993. These laws do not fully regulate the relationships in formation, activity and dissolution of cooperatives and need improvement and replenishment.

First, it's worth mentioning that provisions of the law on consumer cooperatives do not match the internationally accepted concepts and principles of consumer cooperatives. According to the internationally accepted criteria, consumer cooperatives are a special type of cooperatives. In some cases, these cooperatives are involved only in retail and wholesale sales. The main goal of these cooperatives is to ensure savings in the purchase processes by cooperative owners. Owners' savings are generated as a result of low prices in purchasing comparatively large volumes of inputs and services and in transportation expenses, intense use of more perfect equipment and other favorable factors. In many countries, consumer cooperatives are known as food cooperatives or stores of natural, ecologically pure food, where the agricultural products grown by the cooperative member farmers are sold.

Legislative reforms will have critical significance for development of cooperatives in Armenia. While addressing the importance of the respective laws on cooperatives, it should be also noticed that **legal environment is a necessary but not sufficient condition** for proper development of cooperatives.

To ensure the adequacy of the expected results, the following groups of measures are suggested to be taken:

- Implementation of legal reforms;
- Application of economic stimulation mechanisms;
- Raising awareness on cooperative values and principles.

---

<sup>1</sup> According to data of the RA State Register.

## Legal reforms

Specialists claim that the development of cooperatives is impossible without related legislative regulations. All functions of cooperatives starting from their registration to their dissolution should be regulated by law. The law has to also set out the common framework of rules, on the basis of which founding members of cooperatives will develop the cooperative's charter and the internal regulations.

There is a tendency now to have one comprehensive law on cooperatives, where specificities of all types of cooperatives will be presented. According to specialists of the International Co-operative Alliance (ICA), having one main law on cooperatives creates equal conditions, decreases possibilities of fraud, and provides a better position for the cooperative's charter<sup>2</sup>.

Thus developing a new general cooperative law is highly recommended. The idea behind is to have such structure in the law, which would allow easy amendments, when needed. When there is a public need to have additional regulations on special types of cooperatives (e.g. social cooperatives, agricultural cooperatives, housing cooperatives, etc.), it should be possible to add just a section to the existing law and regulate the field, rather than creating a new law which could have some contradictions to the existing ones.

*Based on the experience of the studied countries as well as that of ICA, we suggest adopting one main comprehensive and all-embracing law in Armenia, and including in that law provisions on certain types of cooperatives.*

The law should be based on the well known seven principles of cooperatives defined by ICA:

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.

Basically, the cooperative regulations should cover the cooperative identity and present a clear picture of cooperatives and their activities.

Each cooperative, prior to fulfilling its functions, should be registered and obtain a status of a legal entity. An interesting example is the Fiji law, according to which, if the registration agency has doubts about the strategy and the targeted activity of any cooperative, then it can register the cooperative for a probation period first, for maximum of two years. Based on the results of monitoring implemented during the two years, a final decision is taken whether the cooperative meets the presented charter goals and whether its activity is stipulated from the member interests or not. In case if the requirements are met, the cooperative is awarded a full status, and in the opposite situation the application is rejected.

In many countries cooperatives are exempted from fees and duties necessary for registration. In the RA, respectively 20 and 10 EUR-worth state duties are envisaged for registration as well as for change in the number of cooperative members. Registration of each new member is considered to be a change; therefore it results in payment of a 10 EUR-worth fee. Based on this fact, cooperatives don't seem to tend to register their new members.

*Following the current international tendencies, it is suggested to eliminate the duties and fees for registration of cooperatives, for changes, as well as for the seal.*

Legislative changes and amendments that we suggest include the following provisions:

---

<sup>2</sup> [www.ica.coop](http://www.ica.coop)

## ▪ **Establishment of cooperatives**

According to Article 2 of the RA law on consumer cooperatives, a consumer company is a volunteer union of no less than thirty persons. At the Armenian Government's suggestion, removal of the "no less than thirty" provision from the law has been adopted with first reading. We welcome the idea of these suggestions; however removal of this provision only partially addresses the problem. It should be defined also what shall be the minimum number of members who can form a cooperative.

*We believe that the minimum number of members should be five, which will enable to form the necessary management bodies.*

To ensure the financial sustainability of cooperatives, a statutory capital with its minimum limit should be defined. That statutory capital should be formed through the entrance fees or payments of the cooperative members. The limit varies in different countries; for example, according to the charters of cooperatives in the European Union, a limit of 30,000 Euros is defined<sup>3</sup>. Belgium, for instance, has defined 18,550 Euro limit, Latvia, Estonia and the Czech Republic – equivalents of 2,850, 2,500 and 2,000 Euros, respectively.

In the RA legislation on cooperatives, there are no clearly defined provisions about change in the legal status of cooperatives. Since cooperatives are totally different from other business legal entities and they have a special status, transformation of cooperatives into other legal entities must be restricted to escape possible fraud and deception.

## ▪ **Members of cooperatives**

The basic goal of any cooperative is satisfying the interests of its members. To achieve tangible savings through expansion of commodity turnover and production volumes, at the decision of cooperative members, a cooperative may deliver goods and services also to non members<sup>4</sup>. However, the share of those services should be limited, and the cooperative should direct its main services to meet the interests of its members. The shares of its activities shall be clearly defined between the members and non members in the charter of the cooperative.

A cooperative member, in addition to being an owner, shall also participate in the cooperative's management and use its services. There is no sense having non-committed members who are also non-active users of the cooperative's services. Passive members undermine the role of the cooperative and abate the spirit of cooperation.

Based on the Japanese model, we suggest including the following provision, which focuses prevention of artificial cooperatives: *if any member does not use the cooperative for a one-year period, then he/she may be dismissed from the cooperative.*

Currently, to solve the financial problems of cooperatives, laws in many countries allow cooperatives having *investor-members*, who, paying the related fees, acquire the right to use the cooperative's services. Meanwhile, investor-members shall not have the right to vote and shall not participate in the coop's management.

## ▪ **Management bodies of cooperative**

Efficiency of activities of cooperatives mostly depends on the participation of its members in its management. A cooperative shall have obligatory and volunteer management bodies. Currently, management of cooperatives is regulated by Article 119 of the RA Civil Code and Sections 5 and 8 of Article 2 of the law on Consumer Cooperatives; these laws, however, do not fully define the functions of the management bodies. In particular, the functions of executive and control bodies are not clearly presented.

---

<sup>3</sup> The Statute for a European Cooperative Society (Societas Cooperativa Europaea – SCE) 2003.

<sup>4</sup> Urutyun V., Avetisyan S., Agricultural Cooperatives, Yerevan, 2011.

*We suggest to clearly define the functions of the cooperative's obligatory and volunteer management bodies, procedure for formation and the duties thereof, as well as issues related to the formation of respective committees.*

#### ▪ **Funds and status of cooperative**

According to Article 118 of the RA Civil Code, a cooperative can have indivisible funds. This article stipulates the cooperatives not to have indivisible funds.

The indivisible funds are a guarantee for the stability of cooperatives and are used to cover the cooperative's losses. The indivisible funds are not divided between the members and are inaccessible during the cooperative's existence.

In Italy cooperatives are obliged to allocate 30% of their gross revenues to reserves, which are not taxed and could be used in the coverage of loss, but cannot be divided among members. After the dissolution of the cooperative, the reserves of a cooperative are passed to the cooperative federation, which is obliged to use them in the creation or promotion of new cooperatives. In this way the reserves are always remained in the cooperative cycle and are considered as supporting capitals for cooperatives.

The laws on cooperatives in nearly all European and Asian countries that we have studied expressly fix that the indivisible funds of the cooperatives **are obligatory and are not subject to taxation**. To insure the cooperative against unanticipated risks, different countries have defined minimum tariffs of indivisible funds, 5%-30%<sup>5</sup>; e.g. Check Republic and Belgium have defined 10% tariffs for a period until the indivisible funds will be equal to the half of the statutory capital. The example of Poland is preferable, where the indivisible fund has been defined 5% for a period until it becomes equal to the statutory capital<sup>6</sup>.

*We recommend to make the indivisible funds obligatory for cooperatives and to define a minimum threshold of 5% of the annual profit until it reaches to the level of the statutory capital.*

In addition to indivisible funds, cooperatives can have also other funds, e.g. reserve funds and/or bonus funds, to be handled by the cooperative's charter.

While discussing the cooperative development strategy, there is an important and remarkable fact that significantly hampers the development of cooperatives in Armenia. Consumer cooperatives, being non commercial organizations, are unable to get business loans from banks, which is a serious constraint for their development.

Cooperatives shouldn't be distinguished as commercial and non commercial organizations, instead, cooperatives should be considered as business organizations, having right to conduct business activities. However, taking into account their social role, they should be treated differently from investor owned corporations. The different regulations on cooperatives (ex. different tax treatment) are not considered as privileges over other companies, because they are not equal in their characteristics.

If two things are not equal, then we cannot compare and treat them identically, rather, we should have different approaches to each of them to retain the public balance<sup>7</sup>.

*The status of cooperatives must change so that they are considered as business organizations.*

#### ▪ **Taxation of cooperatives**

Taking into account the social component of cooperatives and their favorable activity in the interest of community development, a large number of countries have instituted tax privileges for cooperatives.

---

<sup>5</sup> The Italian law on cooperatives obliges cooperatives to create indivisible funds equal to 30% of their profit.

<sup>6</sup> Euricse, Study on the implementation of the Regulation 1435/2003 on the statute for SCE, 2010.

<sup>7</sup> A. Fici, Interview and discussion about legal structures of cooperatives, Trento, 2012

Cooperatives are mainly taxed according to the level of the incomes of its members, while the deductions to the indivisible funds are tax-exempt. In the Netherlands dividends allocated to the members are exempt from tax. In Lithuania, if at least 50% of the cooperative's income comes from agricultural operations, then they are provided tax privileges; In Italy, deductions to the cooperative funds are tax exempt, while the income tax of the members is considerably cut back; in France, consumer cooperatives are exempt from taxes, if they have been mainly cooperating with the members.

*Cooperatives are considered to be for-profit organizations, however, at the same time they are provided considerable tax privileges.*

#### ▪ **Monitoring of cooperatives**

The obligatory audit fixed in cooperative laws of virtually all countries studied pursues a single goal of making sure that cooperatives are following the defined “rules of the game”. The audit of cooperatives is mostly separated from state functions and is implemented by unions of cooperatives, e.g. in Serbia, Poland, Denmark, and other countries. In other cases, audit is performed by independent auditing organizations, special subdivisions of ministries or associations. Since the cooperative field is still in emerging phase in Armenia, in this case the goal of monitoring should be not levying fines and penalties from cooperatives but supporting and guiding them to the right direction.

*Annual monitoring shall be obligatory, to make sure that cooperatives follow the accepted principles and operate transparently. It should have an advisory character and be separated from the auditing services delivered for companies.*

A new law creation is a process, which best can be done when number of stakeholders, local and international legal experts, economists are involved in the work process. Multi-stakeholder approach will make it possible to localize and match the best international practices with local features, and assure the effectiveness of legal, economic, social and other dimensions in the law.

### **Application of stimulating economic mechanisms**

As mentioned above, implementation of legal reforms of legislation on cooperatives is a necessary but not sufficient condition for the development of cooperatives. The most important component of cooperative development is their economic sustainability, which, in turn, requires definite steps to be taken.

The public procurement system can be a stimulating lever for cooperatives, which should be perceived from now on as **partners**. The state assistance programs, in particular loan programs, competitive grant programs, programs envisaged by the RA state budget, etc., should be guided towards strengthening the agricultural cooperatives.

In many countries, taking into account the social component of cooperatives, the cooperatives are given advantages; in Italy, for instance, cooperatives are given advantages during the supply tenders for meeting the state needs.

The international experience indicates that cooperatives can be effective partners for the state and can participate in implementation of many social programs. Such partnership is very often a much more powerful lever for economic development of cooperatives than the one-way assistance from the state.

### **Raising awareness about cooperative values and principles**

2012 is declared by the United Nations as the International Year of Cooperatives. This is a favorable opportunity to unite the power of the state and beneficiary stakeholder organizations to strengthen the

perception of the importance of cooperative values among the society. Wrong notions and stereotypes about cooperatives frequently become the main reasons of their failure.

Along with the state and beneficiary organizations, the most powerful resource of cooperatives are the cooperative members, therefore campaign and awareness on cooperative principles and values are among the most important conditions to be successful.

The first Saturday of July is to be celebrated by the UN as the International Day of Cooperatives. An appropriate celebration of this day by the Ministry of Agriculture and other interested agencies will significantly fuel the society's confidence for cooperatives and their principles and values.

## References

1. Urutyanyan V., Avetisyan S., Agricultural Cooperatives, Yerevan, 2011 (in Armenian).
2. Data of the RA State Registry, 2011 (in Armenian).
3. Antonio Fici, Italian Cooperative Law Reform and Cooperative Principles, Euricse, Italy, 2010.
4. Armenian Law on Consumer Cooperatives, 1993.
5. A Study of Cooperative Legislation in Selected Asian and Pacific Countries, FAO.
6. CA, The Austrian cooperative law in a changing world of times, framework since 1873, European research conference, Lion.
7. Cooperative Society Act, 1973.
8. H. Henry, Guidelines for Cooperative Legislation, ICA, 2001.
9. ICARE Country Report, 2010.
10. Kimberley A. Zeuli and Robert Cropp, Cooperative Principles and Practices in 21st Century, 2004.
11. Legal Framework for Social Enterprises in Serbia, Grupa 484, Belgrade, 2011.
12. National Statistical Service of Armenia, 2010.
13. Ninoslav Kekic, Ministry of Economy of Serbia, Presentation of a New Law.
14. Recommendation R193, The General Conference, ILO, 2002.
15. Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society, Euricse, 2010.
16. Supportive Environment for Cooperatives, Report on an Expert Group Held in Ulaanbaatar, Mongolia, UN, 2002.
17. [www.ica.coop](http://www.ica.coop)
18. [www.coopac.coop/idc/](http://www.coopac.coop/idc/)
19. [www.ilo.org/public/english/employment/ent/papers/favclim.htm](http://www.ilo.org/public/english/employment/ent/papers/favclim.htm)