

## **Policy Fellowship Initiative**

# Legal Reforms Needed for the Effective Development of Cooperatives in Armenia



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## **Background**

Groups of individuals around the world and throughout the time have worked together in pursuit of common goals, creating a certain joint business model, which origins come from Europe and North America during 17<sup>th</sup> and 18<sup>th</sup> centuries. According to the International Cooperative Alliance (ICA) “A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise”. The voluntary membership and equal rights are essential elements of cooperatives’ principles.

Cooperatives have played a crucial role in overcoming the difficulties, entrepreneurs are faced when operating individually. They provide them with an opportunity to minimize the losses arisen from low scale production and high fixed costs, benefiting from collective cost sharing and group power. In many countries cooperatives are significant social and economic actors in development of national economies and providing social protection to citizens.

After the collapse of Soviet Union in 1991, and privatization of land and main means of production Armenian rural population was provided with small size lands. Each household received on average 1.4 ha of land and faced with the problems of transformation from one political and economic system into another. The small, fragmented land sizes did not allow farmers to efficiently organize the agricultural production. Fixed costs of machinery and means of production were high, business and management skills among the farmers were low. These resulted in weak relationships with the processors lack the necessary bargaining power.

Number of experts and stakeholders of the field, including the state officials stated not once that one of the significant solutions to the fragmented land and low scale production is developed integration of cooperatives into the national economy system. The development of agricultural cooperatives is underlined by the Government in the Agricultural and Rural Sustainable Development Strategy of Armenia for 2010-2020. It is stated that the government is ready to assist and facilitate the processes of land consolidation and cooperative development through the creation of supportive environment and legal system. International experience shows that cooperatives can play crucial role in the development of national economy and provide social and economic protection to its’ members. Although number of international organizations, several state programs supported the foundation and creation of cooperatives, predominantly in agriculture, most of them didn’t achieve efficiency because of number of economical, legal, cultural, sometimes personal problems.

As one of the main principles of cooperatives is voluntary membership, the cooperatives (Kolkhozes) from Soviet times were representing not real cooperatives. Mistreating the term cooperative with the Soviet times cooperative type is currently one of the major obstacles, which creates cultural burdens among farmers and makes them conscious about joining an entity with a name cooperative. Besides, cultural and informational obstacles, there are number of legal and economic difficulties, which hamper the development of cooperatives in the country. The absence of appropriate law and comprehensive legal environment, ineffective economic

supportive mechanisms, lack of social protection instruments, limited integration to the global trends and developments create a fertile ground for weak and fragile cooperative environment.

The gaps and weaknesses hampering the cooperative development were underlined in the research, number of solutions and mechanisms were proposed based on the experience of European, Asian countries, International Cooperative Alliance (ICA), International Labor Organization (ILO) and UN guidelines and recommendations, European leading research institutions' findings. Major section is devoted to the experience of Serbia as we were provided with an opportunity to closely investigate Serbian practices and developments, meet with stakeholders in the field, visit cooperatives and cooperative unions, talk with legal experts and NGO representatives who initiated a new draft law on cooperatives, get acquainted with their experience, motivations, analyses and projections. The Serbian experience and recent innovations in the field can be very beneficial for Armenia, as both countries have much common in terms of similar historical socialist regime, predominant agrarian sector, small scale farmers etc.

Local problems and weaknesses in cooperative field in line with assessment of international practices and experiences served as a basis to propose the following recommendations to the Armenian government:

- revise the existing legislation,
- implement economically supportive policy towards cooperatives,
- create incentives and promote cooperative values and principles,
- develop social cooperatives, as an innovative solution to employment and social problems,
- conduct effective monitoring and provide protection.

Detailed recommendations and policy mechanisms are presented in this research, including how to create a new law, what essential provisions to include, what innovative social and economic mechanisms are expected to have greatest impact etc. Implementation of the recommended actions is expected to significantly affect the cooperative sector and boost their development. Expected outcomes will include strong and grouped cooperative practices, common solutions to individual problems, enhanced bargaining power, socially protected citizens, employment opportunities for people with disabilities, concern and feedback to community.

## **Introduction**

In line with their economic goals, cooperatives can be interpreted as socially-oriented firms: they are entrepreneurial organizations that do not have in 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). They are created to protect first and foremost their members through the satisfaction of their needs, which can be private or social in nature. Cooperatives operate in different industries, which reflect their types and nature. There are farming, housing, consumers', craftsmen's, youth, student, social and other types of cooperatives for production, sales, service provision and for performing other activities in line with laws.

Recent developments' and innovations throughout Europe put much attention on relatively new type of cooperative, called social, which is a type of cooperative specially designed to provide social benefits to its' members. Italy was one of the initiators of social cooperatives, adopting a special law in 1991. Currently number of countries adopted special laws on social cooperatives, regulating their practices and provided privileges. Social cooperatives carry out various activities with the purpose to achieve social, economic and labor inclusion, as well as to meet other similar needs of vulnerable social groups. Social cooperatives usually are obliged to invest a part of the profit they achieve by carrying out their activities into improvement of healthcare and social protection, education, employment, social, economic and labor inclusion, living conditions, labor skills, life standard and meeting the needs of vulnerable social groups' members.

Although there are different types of cooperatives, and number of industries will benefit upon their development, we will focus our attention to particularly three types of cooperatives: agricultural, consumer and social.

Agriculture is the biggest employer in Armenia. Being a transition country, Armenia greatly depends on agriculture. The share of agriculture in the GDP for the last 2010 year is 17.4%<sup>1</sup>. About 46% of employment in Armenia and about 60% of income in rural areas was due to the agricultural sector for the past 5 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%)<sup>2</sup>. Hence, it should be mentioned that all these just point to a single thing that agriculture is critical for Armenia. Specifically, improving agriculture could lead to poverty reduction, food and social security, increase in quality of life especially in rural areas, stability, and strategic improvement of the other sectors.

Armenian cooperatives were subjected to tight State control until the end of the 1980s. At this time, new industrial and service cooperatives emerged, as a result of the adoption of the Law on Cooperatives in the USSR initiated by M. Gorbachev in 1988. This Law was aimed at

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<sup>1</sup> National Statistical Service of Armenia, 2010

<sup>2</sup> ICARE Country Report, 2010

developing private entrepreneurship through the cooperative sector without changing the basic characteristics of the old system. Between 1988 and 1991, a large number of ‘new’ cooperatives were set up. However, with the beginning of the reform, practically all the ‘new’ cooperatives turned into private enterprises which, at the time, seemed more appropriate and promising for entrepreneurial activity. The Armenian cooperative movement was not prepared to face the consequences of the collapse of the socialist regime<sup>3</sup>. The cooperative members were poor and relatively uneducated peasants, with extremely weak financial resources. Since 90s number of international organizations supported the creation and development of cooperatives in Armenia. However, in most of the cases after the closure of the programs, the sustainability of the cooperatives was sharply declining and the cooperatives were facing heavy operational problems.

The development of cooperatives as an agricultural development tool is underlined by the government in the Agricultural and Rural Sustainable Development Strategy of Armenia in 2010-2020. It is stated that the Government is ready to assist and facilitate the processes of land consolidation and cooperative development through the creation of supportive environment and legal system. It is also important to mention that first 4 actions of the Program are related to development of agricultural cooperative forms and mechanisms as well as establishment of favorable conditions for coop functioning, improvement of legislation and development of missing legal acts needed for realization of the goals of the Program. According to the program the government is ready to spend about AMD 400 mln. for the creation and promotion of cooperatives annually. We cannot evaluate the amount as it is not specified particularly for which expenses it is projected. We believe that in order to achieve sustainable development and tangible results it is necessary to start from structural reforms and create attractive environment where the cooperatives can develop themselves and prosper, rather than support to only cooperative creation, where limited knowledge and weak skills of cooperative members threat cooperative’s sustainability.

One of the few amendments by the government was the recent elimination of the required minimal number of members (30). Before, in the consumer cooperative law of Armenia, it was mentioned that in order to create a cooperative a minimal number of 30 people was required. The National Assembly, with the suggestion of the government, eliminated the “30 member” principle, however, rising number of unanswered concerns.

Another initiative of the government didn’t have success as well. In 2009 the Ministry of Agriculture drafted and proposed a separate law on agricultural cooperatives. The law highlighted the main provisions needed for formation of a cooperative. The law was not accepted and was postponed. We analyzed the main provisions of the draft law in the context of global developments, and suggested recommendations to improve the effectiveness of the law and localize the best practices.

Not having a separate law on cooperatives is generally not recommended by experts. Such solution might result in serious regulative gaps and the coordination of the regulation of all the

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<sup>3</sup> Transition to cooperative entrepreneurship, International labor Organization, 2002

issues is usually problematic. Besides, regulating cooperatives as part of a civil code or commercial code is not effective. Ensuring cooperative values and principles on the level of the law is of prime importance. In practice, there is a need to regulate the field of cooperatives in detail with laws. However, alongside with the global tendencies, the law shouldn't be too detailed, and interfere the autonomy of cooperatives. The government should create appropriate framework, to prevent unwanted manipulations, leaving space for internal regulations to cooperative internal charter. It is commonly believed that the role of the government in cooperative affairs be restricted into four functions: legislation, registration, dissolution and monitoring the applications of the law by the cooperatives<sup>4</sup>.

According to the experts there are no cooperative movements prospering without legal rules applicable to them. Three main reasons for this may be given:

- The existence of a cooperative law is a **necessary but not a sufficient** condition for getting a cooperative policy to work. Law is a reference point and a guide mark.
- In order to provide for legal security, the law has to establish the criteria for the definition of the patrons, the power of their organs and their liability
- Law is a suitable and tested means to represent and maintain the just balance between the autonomy of the cooperators and the cooperatives on the one hand, and the scope of normative control by the state on the other.

Starting with their formation and ending with their dissolution, cooperatives as legal entities have to be subject to legislation. Their internal functioning as well as their position versus third parties has to be regulated.

The following main topics of a cooperative law will be presented here:

- Preamble
- General Provisions
- Formation, registration and publication of the registration
- Obligations and rights of the members
- Organs and management of the cooperative
- Capital formation, accounts and distribution of surplus
- Audit
- Forms of dissolution
- Dispute settlement
- Miscellaneous, transitory and final provisions

Cooperatives can be formed differently in different countries. There is no single “ideal” way for cooperative practices to be uniform for every country. Each country has specifications, which contributes to choosing their own way of cooperative policy development. However, the experience of the countries, which had successes and failures, is an essential element to be

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<sup>4</sup> H. Henry, Guidelines for Cooperative Legislation, ICA, 2001

investigated. For that purpose we examined the cooperative development mechanisms across countries.

The specific character of a cooperative, as part association and part economic enterprise; must be reflected in the law. For example, there should be provisions on the distribution of powers among the general assembly, the board and the manager, capital formation, profit distribution, etc.

Cooperatives need to be regulated and supervised in order to be protected from abuses such as the fraudulent misuse of cooperative funds; the misuse of the name and identity of the cooperative for non-cooperative activities. Clear legislation is also needed to defend and protect cooperatives from various takeovers, privatization, and illegal alleviation of cooperative property by the directors: cases, which were present in Armenia as well.

Cooperatives should be free to accumulate capital, acquire new businesses, enter joint ventures and partnerships, leverage technical knowledge and access to markets, participate in international trade to undertake innovations.

The role of the government should not be limited in creating only the legislative framework for cooperatives. As it was mentioned, the legislation is necessary but far not sufficient to achieve the development. One of the development and promotional mechanisms is the practice of partnership with cooperatives. Cooperatives are not considered only as a subject of assistance, but as a partner, which can provide goods and services to the government.

In order to better coordinate and support the activities of cooperatives some countries have cooperative departments in the structure of Agricultural Ministries or within the Government, which provide advice to government on how various its policies would affect the operation and development of cooperatives.

It is obvious that sustainable environment for the cooperative development cannot be achieved by quick fixes or simple formulas. Ultimately only the cooperatives themselves can mobilize, involve and inspire their members to act in their own interest and that of their communities. Cooperative capacity for genuine partnership with government cannot be developed by governmental regulation that prevents innovation in the cooperative sector. The regulatory, economic and cultural contexts for cooperatives are needed to be addressed together as they clearly influence each other's impact<sup>5</sup>.

Cooperatives must be fully committed to the process and led by people with an broad vision of the cooperatives social and economic purpose and who understand the need for a mutually supportive relationship between both these dimensions to ensure a truly sustainable environment for cooperatives.

To achieve these results, intensive promotional and educational campaigns are needed to educate people about the cooperative values, activities, distinctions and management skills. Without educated member-users it would be impossible to achieve the desired level of sustainable development, as in most of the cases the collapse and bankruptcy of cooperatives are due to the improper understanding, ineffective management, weak control, improper usage of cooperative services and other factors that are primarily related to scarce educational and learning activities.

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<sup>5</sup> Supportive Environment for Cooperatives, Report on an Expert Group Held in Ulaanbaatar, Mongolia, UN, 2002

Governments should ensure a legislative and policy environment that permits cooperatives the full flexibility they need to respond to their globalised competitive environment in particular by facilitating cooperative ability to purchase subsidiary businesses, enter joint ventures, trade and invest across national boundaries and merge their activities in whole or part with other cooperatives. In addition to the flexibility, effective and appropriate audit processes and standards need to be established in consultation with cooperative organizations at the international level to ensure agreed standards to facilitate collaboration and transparency.

## **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.

The baseline for each law, which defines the cooperative values and identity, is considered commonly accepted seven ICA principles<sup>6</sup>:

1. Voluntary and open membership.
2. Democratic member control.
3. Member economic participation.
4. Autonomy and independence.
5. Education, training and information to members.
6. Cooperation among cooperatives.
7. Concern for community.

The provisions in the cooperative law should be commensurate to these principles, or at least not contradict them.

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<sup>6</sup> [www.ica.coop](http://www.ica.coop)

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 19<sup>th</sup> 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 20<sup>th</sup> 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 20<sup>th</sup> 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 for development of 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>7</sup>.

In Asian countries currently two types of cooperative laws are prevailing: common cooperative law, and sectoral 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 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:

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<sup>7</sup> A Study of Cooperative Legislation in Selected Asian and Pacific Countries, FAO.

- 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>8</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 governing 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 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.

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<sup>8</sup> A Study of Cooperative Legislation in Selected Asian and Pacific Countries, FAO

## 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.

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.

In 2003 The EU implemented the Statute for European Cooperative Society (SCE), which ought to harmonize the national laws of the member countries. 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>9</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>10</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

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<sup>9</sup> ICA, The Austrian cooperative law in a changing world of times, framework since 1873, European research conference, Lion

<sup>10</sup> Cooperative Society Act, 1973

investor-members to a limited extent. Specific tax treatment only applies to surplus allocated to the reserve fund<sup>11</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 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>12</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 favorable legislation puting 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.

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<sup>11</sup> <http://www.ilo.org/public/english/employment/ent/papers/favclim.htm>

<sup>12</sup> Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society, Euricse, 2010

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

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.

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. 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. One of the innovations in the law is inclusion of special provisions on **Social Cooperative** as a legal form, which is discussed in more details in Annex 1.

Cooperative development programs in Serbia are based on partnership principles. The Government partners the newly established cooperatives, by providing them with land and procuring their produce. Other state support mechanism was special regional loans for cooperatives, where they were exempted from interest payment for 5 years, until they reach efficiency

## **Analysis and Findings**

The United Nations declared the year 2012 as International Year for Cooperatives aiming to raise public awareness of the contributions of cooperative enterprises to poverty reduction, employment generation and social integration<sup>13</sup>. Number of countries are preparing to implement reforms and offer new, innovative solutions to create favorable conditions for cooperative societies. In this context it is good opportunity for Armenian government to integrate to the international society and implement structural changes in favor of creating an attractive cooperative environment. The reforms will strengthen the development of cooperative business models, as an alternative means for social and economic development in the country.

Today cooperatives represent a powerful tool for cost cutting, income generating, creating employment opportunities and enhancing the livelihoods of individuals, meanwhile contributing to the community development. The distinctive function of cooperatives, compared to the other entrepreneurial forms is in its social function, which makes them a major tool for fighting against poverty.

International experience shows, that there are number of mechanisms and instruments, which could be useful for developing the cooperative sector in the country. The analysis of international experience in cooperative development showed that in order to achieve tangible results in the field it is necessary to:

- Examine policy and legislative framework, needs and opportunities, key challenges, best practices and innovative solutions,
- Create awareness among the stakeholders about the role of cooperatives, assess their achievements and shortcomings,
- Strengthen collaboration and partnership opportunities between cooperatives and social partners, including the government,
- Promote cooperative values among current and prospective members based on ICA principles,
- Monitor and regulate the field, meanwhile assuring the limited interference in the daily activities of cooperatives.

Based on the above mentioned mechanisms, the following specific actions are recommended to be implemented in Armenia, to ensure the sustainable development of cooperatives:

- create new law on cooperatives,
- implement economically supportive policy towards cooperatives,

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<sup>13</sup> [www.social.un.org](http://www.social.un.org)

- create development incentives and promote cooperative values,
- develop social cooperatives, as an innovative solution in overcoming social problems,
- conduct monitoring and provide protection.

### Framework of New Legislation on Cooperatives for Armenia

As it was mentioned above, in order to achieve sustainable development of cooperatives in the country it is not sufficient, but necessary to have comprehensive and regulative legislative legal framework, which would regulate the field. The purpose of enacting cooperative law should be to give a legal status to the cooperatives and facilitate their working. It should also ensure that cooperatives work as genuine bodies and in accordance to the universally accepted cooperative principles.

At present the laws that regulate the field are the national Law on Consumer Cooperatives, implemented in 1993, and 5 articles in Armenian Civil Code. The laws are outdated and don't regulate and facilitate the cooperative development in the country. The Ministry of Agriculture (MOA) developed and proposed a law on Agricultural Cooperatives, which was one step ahead from the current laws. However, it also had several gaps, and limitations and was rejected by the Ministry of Justice. One of the reasons for rejection was the proposed tax preference for cooperatives. Started from January 1<sup>st</sup> of 2009 the farmers were subject to the Value Added Tax (VAT) when exceeding the AMD 58.35 mln. Alone farmers might not reach to the taxed border; however, when joining a cooperative, together they can cross the defined amount of turnover and be subject to VAT tax. It was suggested that the turnover amount would be spread on each member of a cooperative, which would not be an obstacle for creating a cooperative<sup>14</sup>.

Based on the limitations of current laws, and taking into account the draft law on agricultural cooperatives, we will present recommendations, to be included in the New Draft Law, which would take into account the international developments and their relevance to localize.

It is extremely important to provide cooperatives with the proposed VAT exemption to eliminate the economic barriers and create motivation to form a cooperative.

Taxation issues of cooperatives were extensively discussed and the general view of several countries was that the surplus a cooperative accumulates cannot be categorized as profit because it represents “cost plus surplus” that should be returned to members as patronage refund.

The first question when drafting a law on cooperatives is whether to have a general law on all the types of cooperatives, or to have different laws on each type of cooperative. When analyzing the international experience, it is evident that there is a tendency of having one general law on cooperatives. The trend is towards having one single general law covering all types of cooperatives because it is believed that: one law for all types of cooperatives, possibly with specific parts for specific types of cooperatives, for example agricultural or housing cooperatives, best guarantees the autonomy of cooperatives, i.e. their power to regulate their own

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<sup>14</sup> Urutyanyan V., Avetisyan S., Agricultural Cooperatives, Yerevan, 2011

affairs as far as possible through bylaws, since the degree of detail in such a law will be lower than in a multitude of laws:

- this low degree of detail diminishes bureaucracy,
- one single law avoids the fragmentation of the cooperative movement that might occur where different types of coops were registered under different acts and placed under the supervision of different public authorities with, perhaps, heterogeneous policies,
- one single law creates legal security for those dealing with cooperatives. Legal security relates rather to structural and liability aspects than to a specific type of activity of a cooperative,
- in the context of development constraints, one single law is the most adequate tool to reach congruency between development oriented, member oriented and self-sufficiency goals of cooperatives<sup>15</sup>.

The best law is that which is simple and brief, which can be understood by the common man. Working details should be left to the members, to be included in the bye-laws.

Although a draft of Agricultural Cooperative law was developed by the MOA, the adoption of it would not regulate comprehensively all the aspects of cooperatives, as such important provisions as minimum number of members, investment mechanisms, book keeping, cooperative alliances and secondary cooperatives, cooperative transformation mechanisms, management structures, cooperative auditing, penalty provisions etc. were not adequate in the draft law. The following chapters are recommended based on the European and Asian experiences in accordance with ICA, ILO and UN principles.

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

Based on the international experience, the best cooperative concept can be stated as following:

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, consumer, social. Cooperatives can carry out other activities in accordance with law.

### **Foundation of cooperatives**

In addition to the gaps in the draft law, there were provisions which are not in line with cooperative principles and can deteriorate the cooperative activities. Particularly, in the draft law it is mentioned that cooperative can be formed by two (and more) physical or legal persons<sup>16</sup>.

**First:** it is impossible to form a cooperative with two persons, as it would be impossible to form a general assembly, which makes decisions based on the majority of votes.

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<sup>15</sup> [www.ica.coop](http://www.ica.coop)

<sup>16</sup> Draft Law on Agricultural Cooperatives, Chapter 2, Article 4

**Second:** legal persons cannot be members of cooperative, as a cooperative comprised of two legal persons (ex. LLC) will raise a number of controversial tax treatment, management and other issues, and definitely will not have accepted cooperative principles.

It is suggested to mention in the law that cooperatives can be formed by at least **five physical persons**, which would ease the formation procedure, meanwhile retaining the cooperative values.

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.

We would like to underline one important provision in the draft law that exempts cooperatives from registration fees and duties. This is a facilitating tool that definitely should be included in the final law. The registration procedure in most of the countries requires a maximum period within which a cooperative should be granted a legal status or rejected. Here an innovative solution can be Fiji's example, where in case of hesitations a cooperative is granted an experimental status for one year, after which the activities are revealed.

### **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**

Management bodies, their structures and functions of a cooperative are presented in the Armenian Draft Law not adequately. The Serbian experience here could be very appropriate, when there are mandatory and non mandatory organs.

General Assembly, Steering Committee and Director represent mandatory bodies of cooperative management.

A cooperative can also elect Supervisory Board, which is not mandatory. Supervisory Boards is a facultative cooperative body, and if a cooperative does not elect a Supervisory Boards, the competences of the Supervisory Board as stipulated in this Law shall be transferred to the cooperative's Steering Committee, which should consist of at least three members, and the director and the chairman of General Assembly cannot be the member.

As usually the General Assembly is invited once in a year, it is suggested that the power of attorney to accept new members is transferred from General Assembly to the Steering Committee.

Cooperative is managed by members of a cooperative by one-member one-vote principle.

### **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.

### **Taxes, profit and loss coverage**

Still there is a public debate regarding the status of the cooperative. Some consider cooperatives as non-profit organizations, taking into account the members prevalence over the company's profit. The others consider that, although cooperatives' surplus is distributed among members, after mandatory payments to reserve funds (on average from 5-10%), cooperatives cannot be considered as non-profit organizations, as they do compete in the market on commercial basis.

In Armenian law cooperatives are considered as non-profit organizations. In our opinion, although the surplus of a cooperative cannot be considered as profit, cooperatives cannot be considered as non-profit, which deteriorate their abilities to receive loans, participate in tenders, compete with other commercial firms.

In most of the examined cases cooperatives are taxed on their member level by income tax. The distribution of profit is decided by the assembly upon adoption of financial report with the following sequence: first to cover the loses, then, make payments to the reserve funds and distribute the refunds to the members according to their contribution. Loses 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 or education.

### **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. It is interesting to note the Serbian case, where 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.

### **Cooperative audit**

In examined every cooperative law (except the Armenian draft law) the audit of cooperatives was mandatory, implementation of which were differing from country to country. Annual audit is necessary to maintain the democratic governance of shareholders and facilitate transparency. Usually the auditing process is distinguished from governmental bodies. In most cases the

management board outsources a qualified auditor or auditing company, or it is conducted by cooperative unions, which usually hold necessary auditing permission. If cooperatives are given the right to engage in certain activities, they should also be subject to appropriate obligations. 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**

In order to implement effective legislation and prevent misuse or manipulations, penalty provisions need to be included in the law, for economic offense and breaking the established rules. Legislation is also needed to defend and protect cooperatives from predatory takeovers and privatization.

Cooperative should be subject to penalties 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.

### **Additional Remarks**

In addition to the mentioned cooperative principles in the draft law, it is suggested to include inter-cooperative collaboration and care for the community, as those are commonly accepted principles which facilitate partnership and community development in different countries.

In the draft law it is unclear whether the cooperative can change its form into another form of a legal entity. Taking into account the special form of a cooperative, it is suggested to prohibit the transformation possibilities of a cooperative into another legal form to prevent the misuse of cooperative's privileges.

It is recommended to follow the global tendencies and implement provisions concerning Social Cooperatives. Social Cooperatives are the most appropriate form of Social Enterprises, which besides having an explicit role to satisfy shareholders also have such goals, as care for the community, education, environmental protection, work integration, support to vulnerable groups etc. Through Social Cooperatives the governments implement number of social activities in benefit of community development and support to vulnerable groups, who are excluded from social benefits.

## Economically Supportive Policy towards Cooperatives

Beyond drafting and passing legislation governing cooperatives in the country, the State needs in a supportive environment to exhibit a consistency of approach, that is, a consistency in the application of laws affecting cooperatives<sup>17</sup>.

In practice, there are some obstacles in front of success of the cooperative movement related with finance, training and research, vertical and horizontal coordination, legal issues, auditing and relationships with the government. On the other hand, lack of education and infrastructure in the rural areas has also created considerable handicaps for cooperative movement. Several support mechanisms could significantly facilitate the development of cooperative sector in the country.

Although the State is expected to encourage cooperative development, it is also essential for it not to interfere totally in the management of cooperatives. Any incentives by the authorities must be temporary and transitory out of a clear concern for independence.

In some countries public authorities have within them working departments dealing exclusively with cooperatives. To effectively support the sector and handle all the tasks effectively it might be necessary to establish a separate department in the Agricultural Ministry. This department could have a task of broadcasting the principles and rules governing cooperatives, assist members to set up and organize cooperatives, help to run and manage them by providing with information, advice and the necessary control. Representation of cooperatives within the state system is an important issue. Given the variety of activities assumed by the cooperative movement, it would be better for there to be, within the public services, a unit specially designed to promote the interests of cooperatives.

### **Partnerships 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

<sup>17</sup> Supportive Environment for Cooperatives, Report on an Expert Group Held in Ulaanbaatar, Mongolia, UN, 2002

The above examples show the possible cooperation among the government and cooperatives, where the cooperative is considered as a partner, which has concerns for the community. New forms of contractual relationships may be developed whereby cooperatives provide services that were previously subsidized by the State. However, if cooperatives do provide such services it is important that the relationship between them and the State is clear. Partnership with NGOs, Governmental bodies and other stakeholders are proved to be a better tool, rather than direct subsidy to create a cooperative, which will later collapse because of its weakness to face the market and competition challenges.

In the initial stages of economic activity the essential need for the cooperative is to have reliable partners. In some countries Governments established efficient partnerships with cooperatives, to economically fuel them in their initial stages, meanwhile solve some multi-aim social problems. Partnership between the Government and cooperatives could be established where the free market process had been unable to deliver effective economic and social development, and where government was also withdrawing from the provision of services. In these instances an effective partnership requires the State to facilitate the development of cooperatives. In the above sections we brought several examples of this kind of partnerships, when the Government procures goods and from Cooperatives for provision of social services to the Community. Basically, the partnership can be described as a triangle, where the Government, the Cooperative and the Community are the main actors.

### Education and Promotion of Cooperative Values

The Governments can implement a number of policies towards facilitating cooperative creation. This process, however, is most effective, when it starts from members themselves. This means that the cooperative members realize the advantages of voluntary uniting and cooperation<sup>18</sup>. In this context we can state that the base of cooperative success are its' members. Educated, acknowledged, enthusiastic and productive members are the main and most important resources of any cooperative. Hence, to achieve sustainable development and prosperity in the field, alongside with legislative framework and economically supportive policy there should be adequate promotion of cooperative advantages, education of cooperative values and principles, strengthening the positive image of cooperatives.

Learning and education are essential elements of cooperative development. Especially in Armenia, where farmers still associate the word “Cooperative” with the soviet type cooperatives,

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<sup>18</sup> Urutyanyan V., Avetisyan S., Agricultural Cooperatives, Yerevan, 2011

with which they don't have the best memories. Systemized promotional campaigns are needed to educate people and create positive image of cooperatives. Promotional campaigns through mass media, systematic educational and extension programs through Agricultural Support Regional Centers definitely will have their positive effect.

The year 2012 is announced as the International Year of Cooperatives. This is a good opportunity for the government to integrate with international cooperative society and implement structural changes that will have significant effects on the field. Celebrating the Year of Cooperatives via implementation of several promotional events throughout the country will be a strong start towards development.

In addition, United Nations is annually celebrating the day of the cooperative in the first Saturday of July. The aim of the International Day of Cooperatives declared by the United Nations in 1995 is to increase awareness on cooperatives, highlight the complementarity of the goals and objectives of the United Nations and the international co-operative movement and, underscore the contribution of the movement to the resolution of the major problems addressed by the United Nations. The International Day also aims to strengthen and extend partnerships between the international cooperative movement and other actors, including governments, at local, national and international levels<sup>19</sup>.

Celebrating the day of a Cooperative, will definitely contribute to the enhancement of awareness and acknowledgment of common cooperative values, and increase the attractiveness to join, create, use and benefit from a Cooperative.

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<sup>19</sup> [www.coopac.coop/idc/](http://www.coopac.coop/idc/)

## **Summary and Conclusions**

Summing up the results it becomes evident that the Government can implement appropriate mechanisms for sustainable development of cooperative sector. Assessment of international practices shows that governments have essential roles in facilitating the efficiency of cooperatives and promoting their values. In number of examined countries cooperatives are treated specially due to their apparent social functions. Cooperatives are legal entities, which main goals are maximization of member-patrons benefits, rather than high returns per invested capital. The universally accepted cooperative principles and values, where concern for the community, social well being of members, democratically owned and controlled mechanisms are highly underlined, make them different from other legal entities and organizations.

For supporting and fueling the effective developments of the sector, governments implement several mechanisms, which support the cooperatives, meanwhile, not affecting their autonomy. The functions of governments are usually limited to creation of regulative legislation framework, economic support, promotion of cooperative values and ensuring protection. Examination of European and Asian countries showed, that the experience of many countries can be useful when designing a supportive policy. Assessment of cooperative sector and legislative innovations of Serbia proved that the country is on its way of creating a new stage for cooperative developments. Particularly, the new Draft Law on cooperatives contains several innovative provisions on cooperative types, their ownership, organizational and management procedures. Provisions on social cooperatives, in accordance with the developments coming from European Union, will strengthen the expansion of social cooperatives in the country.

Global experience of countries can be very useful for Armenia when drafting cooperative legislation and designing policy. Based on the above mentioned mechanisms, the following specific actions are recommended to be implemented in Armenia, to ensure the sustainable development of cooperatives:

- create new law on cooperatives,
- implement economically supportive policy towards cooperatives,
- create development incentives and promote cooperative values,
- develop social cooperatives, as an innovative solution in overcoming social problems,
- conduct monitoring and provide protection.

Although a draft of Agricultural Cooperative law was developed by the MOA, the adoption of it would not regulate comprehensively all the aspects of cooperatives, as such important provisions as minimum number of members, investment mechanisms, book keeping, cooperative alliances

and secondary cooperatives, cooperative transformation mechanisms, management structures, cooperative auditing, penalty provisions etc. were not adequate in the draft law.

Appropriate recommendations are presented to modify the draft law, and enhance its usefulness.

For implementing an economically supportive policy towards cooperative developments it is suggested to consider cooperatives as partners, and implement state procurement mechanisms directly from cooperatives.

To achieve sustainable development and prosperity in the field, alongside with legislative framework and economically supportive policy there should be adequate promotion of cooperative practices, education of members on cooperative values and principles, strengthening the positive image of cooperatives. Educated, acknowledged, enthusiastic and productive members are the main and most important resources of any cooperative.

2012 is announced as International Year for Cooperatives. This is a good opportunity for the government to integrate with international cooperative society and implement structural changes that will have significant effects on the field. Celebrating the Year of Cooperatives via implementation of several promotional events throughout the country will be a strong start towards development.

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## **Annex 1**

### **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>20</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
- 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

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<sup>20</sup> OECD, 1999

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 analyzing 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 Labor 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' experiences, 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 labor market. For this purpose, work integration social enterprises integrate disadvantaged people into work and society through productive activity, thus favoring a more effective allocation of society's human resources<sup>21</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,

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<sup>21</sup> Borzaga, Gui and Povinelli, 2001

especially for the management of activities aimed at integrating disadvantaged workers into the labor 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.

### **Case 2: 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 disabled person, or make some contributions to the pensions funds for people with disabilities, otherwise they should buy from the unions of disabled 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.

