Research on Rural Development European Union’s Legislation in 2012

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Abstract: The imbalances in bargaining power between the contracting parties in the food supply chain have drawn much scholarly attention but have also been closely examined by policy makers. The European Commission is committed to facilitate the restructuring of the agricultural sector by encouraging the creation of voluntary agricultural producer organisations. DG Agriculture and Rural Development has launched a large study, “Support for Farmers’ Cooperatives” (hereafter: SFC), to provide background knowledge that will help farmers organise themselves in cooperatives as a means to consolidate their market orientation and so generate a solid market income.

Key words: merger legislation, rules, rural development, business strategy

INTRODUCTION

The position of cooperatives in the food supply chain refers to the competitiveness of cooperatives vis-à-vis its partners, such as processors, wholesalers and retailers. It also refers to the strategy that the cooperative follows in choosing a particular position in the food chain. Internal governance refers to the decision-making processes adopted, the role of the different governing bodies, and the allocation of control rights to members and professional management. Further, the internal governance refers to issues such as the organisational structure of the cooperative enterprise (e.g. the formation of holding and daughter companies).

The institutional environment refers to the social, cultural, political and legal context in which cooperative operates, and which may have a supporting or constraining effect on the cooperatives’ performance. History is an important ingredient of the institutional environment. For example, positive past experiences of cooperative development usually have resulted in the generation of trust and has boosted social capital – both necessary for efficient operation of the cooperative as well as for establishing new cooperatives. Legal aspects of the institutional environment, such as taxation and competition laws, are equally crucial in fostering or deterring cooperative development.

In defining cooperatives and producer organisations we have applied the three basic principles developed by Dunn (1988): The User-Owner Principle: Those who own and finance the cooperative are those who use the cooperative; The User-Control Principle: Those who control the cooperative are those who use the cooperative; The User-Benefits Principle: The cooperative’s sole purpose is to provide and distribute benefits to its users on the basis of their use.

These are simple and flexible principles, still encompassing latitude of practices such as open or defined membership and one-member-one-vote or proportional voting. These basic cooperative principles can be found in the following organisational practices. Users typically control cooperatives by democratic decision-making structures. Capitalization of cooperatives is created by direct investments, retained patronage refunds, and per-unit capital retains. Benefits are realized by returning net income (or surplus) to patrons in proportion to use, by receiving/paying fair prices, and by gaining access to markets, supplies, and services. In sum, a cooperative has been defined as a “user-owned and controlled business from which benefits are derived and distributed on the basis of
use” (Dunn, 1988: 85). While many different types of agricultural cooperatives exist in the EU Member States, our study focused on marketing cooperatives.

**MATERIAL AND METHOD**

No evidence was found that national cooperative statutes contain legal restrictions on the acceptance of members from other Member States or on the exercise of their membership rights. Taking into account the established case law of the ECJ on the freedom of movement, cooperatives encounter no restrictions in setting-up subsidiaries in other Member States. The SCE Statute has not been used until now by agricultural producers to form a transnational or international cooperative. Questionable is whether potential members from another Member State can be barred from becoming members, if this represents their sole reliable option. The taxation of members from other Member States has not led to significant problems so far, with the exception of two cases in Sweden/Denmark and France/Germany.

As processing and marketing cooperatives are capital intensive, and finance can be problematic (see Chapter 5) the question is whether cooperatives are legally able to distribute net proceeds taking into account the proportion of capital paid in by members. Our legal analysis shows that cooperative statutes do not restrict members to create tailor-made solutions in their bylaws. It is common practice that the distribution of surplus to members as well as their obligations to participate in self-financing techniques of the cooperative is executed on the basis of the principle of proportionality, according to the volume of transactions of an individual member with the cooperative. In this respect, it is worth mentioning that 22 Member States were reported to have flexible legal rules on the distribution of surplus to cooperative members. However, retaining surplus and accumulating reserves may trigger a loss of the favourable tax treatment.

The virtual absence of raising equity from outside investors is not caused by the lack of an adequate legal structure. Only seven Member States (Belgium, Bulgaria, Cyprus, Estonia, Portugal, Romania and Slovakia) did not allow outside investors to participate in the equity capital of the cooperative. Accordingly, in these Member States voting rights could not be allocated to non-patron members. However, it remains questionable whether in these Member States there is a genuine demand for this legal facility. The other Member States allowed or, more accurately, did not forbid outside investors to participate in raising equity. However, in a substantial number of these Member States this facility was not aligned with the allocation of voting rights to outside investors (Finland, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Sweden and the UK). But even in Member States with both facilities, raising equity from outside investors is still in an embryonic stage. Hence the conclusion that the legal structure of the cooperative is not a dissuasive factor for obtaining equity capital from outside investors.

**RESULTS AND DISCUSSIONS**

With regard to domestic merger legislation, all Member States do have legal provisions for cooperatives to merge with other cooperatives. In Bulgaria, Ireland, Luxembourg, Poland, Portugal, Romania and Slovakia, cooperatives are not permitted to merge with non-cooperative firms. On the other side, Austria, Belgium, Germany, Hungary, Greece, Lithuania and Spain provide a highly flexible set of rules on domestic mergers.

The EU competition rules do not apply unless the agreement or practice has effect on trade between the Member States. In such a situation, national competition rules apply. All Member States currently have national competition legislation that mirrors the rules set out in Articles 101 and 102 TFEU.
In EU competition law cooperatives are assessed, like any other company, on the actual effect of their behaviour in the relevant markets. When assessing the application of Article 101(1) of the TFEU to cooperatives, the Court of Justice has clearly recognised in several occasions the pro-competitive effects stemming from cooperatives and established that the prohibition principle of Article 101(1) does not apply to certain provisions of cooperative agreements, for instance where they are indispensable in order to create countervailing power.

A joint production agreement in the agricultural sector is another example of cooperation agreement that is favourably assessed under the EU competition rules. Under such an agreement farmers group together, as a cooperative or under another name or statute, their complementary productions at an upstream level with the aim of producing agricultural products (wine, cheese, flour, fruit preserves etc.) at a subsequent processing stage. A joint production agreement is unlikely to restrict competition if the parties to the agreement do not have market power in the market on which a restriction of competition is assessed. In fact, joint production agreements benefit from the presumption under EU competition rules that if they are concluded between parties with a combined market share not exceeding 20% in the relevant market(s) they do not restrict competition.31 Above this threshold, a joint production agreement may be allowed if it is possible to demonstrate by an individual assessment that the efficiencies created by the agreement outweigh any competition restrictions.

An often discussed issue for the application of competition rules to cooperatives is the relative strength of the contractual relationship between members and cooperative. A cooperative can enhance its competitiveness by having strong contractual ties with its members. These contracts are meant to clarify the quality requirements that farmers have to comply with (and to explicate the accompanying monitoring and control mechanisms), as well as to restrain farmers from short term exit (as that would jeopardize the efficiency and thus competitiveness of the cooperative firm). In order to avoid excessive market power by a cooperative the Court of Justice's case law32 requires analysing the members' possibilities to exit or withdraw from the cooperative (so that they can operate autonomously or potentially join another competing cooperative) and their freedom to supply third parties other than the cooperative itself.

The overriding principle, however, has been that restrictions upon member exit are not perceived as infringing on competition rules when they are deemed necessary for the cooperative to function efficiently from an economic point of view. Whether the restrictions are necessary has to be established on a case-to-case basis. In this respect, several determinants have been established in case law: market share, the number of other market competitors, whether other market competitors use the same restrictions, whether members are allowed to contract with other market competitors or exclusively with the cooperative, whether an accumulation of restrictions has the power to prevent members from contracting with other market competitors.

Most importantly, national provisions on cooperatives and the EU competition rules must be coordinated. There are numerous cases, where cooperatives may have an effect on trade between Member States. For example a market organisation concerning pricing arrangements of exports or imports or joint purchases from other Member States is by nature international. Before moving from the issues of mergers and competition in the food chain to policy measures in support of cooperatives, this section examines the role of cooperatives in rural development.

In some cases cooperatives build their business strategy even on regional characteristics and social processes (resulting in, e.g., regional or fair trade-type of products and services). PDO-PDG-type of products and links with incoming tourism can
be part of such a strategy. However, in the end, all cooperatives are business oriented: there has to be an income from the market (but sometimes supplemented by subsidies).

Experience has shown that government policies can impede or enhance independent cooperative development. For encouraging the development of cooperatives, public policy has multiple points of entry where it can have a significant effect. In support of cooperative development, policy could opt for indirect measures, for instance through provisions in business and organisation law that make it relatively easy to establish a cooperative. Also, more direct measures can be taken, for instance in the form of subsidies or grants to producer organisations. By identifying policy measures that affect cooperatives and their development, we aim to provide more insights into policy measures that might contribute to creating a conducive policy environment for the development of cooperatives and producer organisations.

When governments want to influence the performance of cooperatives, measures that directly target the position of the cooperative in the food chain are the most cited among our building blocks. Financial or other incentives (including tax), inducements, and cooperative legislation are the most relevant types of policy measures. Internal governance is seen much less as a target for intervention (54 measures), and, of course, cooperative legislation is then the most used policy type. Capacity building and technical assistance are much less used as policy measures to improve internal governance, and when capacity building is used, directly improving the position in the food chain (e.g., with marketing knowledge) is a more important goal. About two thirds of the policies try to correct market and regulatory failures and only a small number try to obtain only equity and social goals.

There exist large differences in the policy measures between Member States. Although this might be due to differences in what is seen as a relevant policy measure in the Member States. With 64 policies, Belgium has the longest list of cooperative-related policies. Other countries with considerable numbers of policies are Bulgaria, Greece, Hungary, Latvia, Poland, Romania, and Spain (all around 20 policies). The large number in Belgium is not only explained by its long cooperative history, but especially also by the federal structure of the country. Then it was decided however to replace these cooperative-specific policies by measures for all agricultural enterprises (which do not affect the relative position of cooperatives).

CONCLUSIONS

Cooperative enterprises are sometimes stereotyped as successful, internationally-oriented businesses in northwest Europe, traditional and socially oriented, struggling with internal governance in the Mediterranean Member States, and problematic in New Member States due to their socialist heritage. Although there is a grain of salt in these stereotypes, the reality facing policy makers is more complex and the description is outright wrong for many cooperatives - especially for many successful cooperatives in the South and East of Europe.

Some sectors are more cooperative than others. This is mainly due to the characteristics of the product and the production process. As explained above, in the dairy and fruit & vegetables sectors cooperatives have an important market share. In sectors like cattle, pigs and sheep the products are more often sold by farmers, often under contracts, to traders or IOF slaughterhouses, but in some countries (hybrid) cooperatives have important market shares in these sectors.

Depending on the options provided by the legal framework in each country, farmer-members may choose among many different models of governance the one that best fits their needs. These models differ among others in the use of supervisory boards, membership councils (in addition to the General Assembly), separation of association and firm, use of professional management, participation of outside experts on boards, non-
member trade and voting in proportion to the value of transactions. However, among the 500 well-known cooperatives in the eight sectors we surveyed, most are relatively small and regionally based cooperatives with a classic internal governance structure. Cooperatives do not easily change their internal governance as that brings quite some uncertainty for members and cooperative leaders. Also the influence of legal and fiscal advisors may lead to conservative choices.

Innovation in internal governance benefits from a flexible cooperative law, so that members can use the bylaws to adapt the governance to their needs. That implies that the law does not give much guidance, e.g. on internal control. In some cases checks and balances in the internal governance can be improved, e.g. by installing supervisory boards and the enhancement of professionalism of (supervisory) board members.

Internal governance is directly related to ownership structure. Some of the (innovative) ownership structures are hybrids, with different organisational arrangements like a cooperative association owning an IOF-like business, producer organisations that jointly own a cooperative, firms owned by farmers' organisations or cooperatives being majority owner of an IOF that is also listed at the stock exchange. Internationalisation has reinforced the emergence of such hybrid structures, as the original farmer-owners do not want to share ownership rights with outsiders, and as managers usually favour running the foreign business on a IOF basis (i.e., a profit centre). As a result, in some large complex hybrids the cooperative character, in terms of user-control by farmers, is hard to evaluate, and membership commitment may be an issue, particularly as control rights of members have weakened.

Professional structures and policies regarding board composition and member incentives affect performance. In our sample, the typical attributes of “professional” cooperatives like proportional voting rights, professional management, include outsiders in the supervisory board, and selection of directors based on expertise or product representation as opposed to regional origin, all have a positive effect on cooperative performance.

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