INSTITUTIONAL ENVIRONMENT AS A FACTOR FOR DEVELOPMENT OF CURRENT BULGARIAN AGRICULTURAL COOPERATIVES

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Abstract:

The cooperatives are traditional organizational form of Bulgarian agriculture. Although existing cooperatives were liquidated by the agrarian reform of 1991, the cooperative organizational form quickly find a place in the new economic conditions in the country.

The purpose of this article is, on the basis of impact assessment of the institutional environment on the cooperatives’ formation and functioning, to outline some guidelines and recommendations for improvement of this environment.

The article analyzes the formal and informal institutional conditions for the development of the agricultural cooperatives. Special attention is paid to existing traditions and legal frameworks, regulating their activities. Based on the findings, the weaknesses of existing institutional environment are determined and some suggestions for improvement are made.

Introduction

Cooperatives are traditional for Bulgaria organizational form. They exist in the country’s agriculture since the 19th century as their characteristics change in parallel with changes in socio-economic environment.

The old organizational forms were liquidated with the launch of Agrarian Reform in 1991 and the process of restoration of private ownership of land and other inputs begins. Although the existing to the reform cooperatives have been liquidated, the cooperative organizational form quickly finds a place in the new economic conditions of the country. Agricultural cooperatives are becoming a key producer of agricultural produce and holder of a significant proportion of agricultural land in Bulgaria.

The new founded structures, however, have relatively uniform pattern, do not allow in a best way to utilize the organization form's advantages and begin to exhibit market instability and low adaptability. According to many authors they are organizations with abating functions.

This raises the questions: what are the main factors which determined the development of contemporary Bulgarian agricultural cooperatives and how they should be adjusted to
facilitate complete and effective use of the cooperative organizational form in the contemporary Bulgarian agriculture.

In an attempt to answer the questions, the purpose of this paper is aimed at identifying some guidelines and recommendations for improving the institutional environment affecting the formation and operation of agricultural cooperatives in Bulgaria.

The main thesis of the study is that the development of contemporary Bulgarian agricultural cooperatives is predetermined by the specificity of the existing institutional environment.

Necessary information for the survey was gained through literature review of papers concerning the nature and characteristics of the cooperative organizational form and institutional environment; review of regulations concerning the formation and operation of agricultural cooperatives in Bulgaria and the collection of empirical data through two separate surveys - one of 21 agricultural cooperatives, determined by a random choice on the basis of the agricultural cooperatives register, taken from the "Bulgarian Cooperative Reference Book", and the second with 5% of the members of a randomly chosen agricultural cooperative.

**Institutions and Institutional Environment**

According to many economists “institutions matter and are susceptible to analysis” (Matthews, 1986, p. 903; Williamson, 1996, p. 3). As Nord mentions (1990, p. 4) “institutions are the rules of the game”. They include the laws and norms by which society lives and the mechanisms created to enforce the rules and norms.

The degree of match between the objectives of institutional constraints and choices that individuals make in the specific institutional environment depends on the effectiveness of enforcement mechanisms. Enforcement is carried out by three different parties - self imposed codes of conduct; retaliation and/or societal sanctions or coercive enforcement by the state (Nord, 1990, p. 3).

Generally institutions can be either formal or informal in nature. Zenger et al. (2001, p. 2) define formal institutions as rules that are readily observable through written documents or rules that are determined and executed through formal position, such as authority or ownership. Formal institutions, thus, include explicit incentives, contractual terms, and firm boundaries as defined by equity positions. The informal institutions, in turn, are defined as rules based on implicit understandings, being in most part socially derived and therefore not accessible through written documents or necessarily sanctioned through formal position. Thus, informal institutions include social norms, routines, and political processes.

According to Ghecham (2006, p.2-3), the link between formal and informal institutions is historically close. Their interconnection is clear; on one hand norms and customs are the basis from which laws and constitutions drive their legitimacy. On the other hand new laws would
lead in the long run to helping to shape potential norms and customs that command the society. In other words, the informal institutions are either embodied in formal institutions or emerge as a result of adopting formal institutions for long period of time.

As the author note, this interaction can be a cooperative or a conflictual process. If formal rules are in harmony with the prevailing informal rules, the interaction of their incentives tends to reduce the level of transactions costs. However, their interaction tends to raise transaction costs when the two forms of rules conflict with each other.

Kraybill and Weber note (1995, p.1266) three categories of institutions affect economic outcomes: political institutions, market institutions and civil institutions. These three categories covering the various fields of socio-economic activity, together determine the institutional environment in which individuals and their organizations exist and grow.

Some authors (Oxley cited by Dickson, 2004, p. 5) define the institutional environment as the set of political, economic, social and legal conventions that establish the foundational basis for production and exchange.

According to others the institutional environment include the systems of formal laws, regulations, and procedures, and informal conventions, customs, and norms, that broaden, mould, and restrain socio-economic activity and behaviour.

As Brousseau and Raynaud mention (2006, p. 2), there is a distinction between institutional environment and institutional arrangements. The former refers to the general institutions of societies that set the “rules of the game” and make them mandatory, either because these rules are enforced by a coercive, last resort power (i.e. the State), or because they represent the beliefs and conventions forming the identity of a society (nation, language, etc.). It includes therefore both its formal and informal components. The institutional environment applies to a large range of heterogeneous transactions. In this sense, it is generic. In contrast, the notion of institutional arrangement refers to mutual (and most often bilateral) commitments established mainly by contracts between agents. Institutional arrangements therefore refer to governance structures and contractual arrangements analyzed by Williamson (1996) and many other scholars. They cover institutions related to arrangements “between economic units that govern the ways in which these units can cooperate and/or compete” (Davis and North, 1971, pp. 6-7).

In this article attention is focused on the institutional environment and its impact on the development of cooperative forms in Bulgarian agriculture.

**Ingredients of institutional environment for the development of current Bulgarian agricultural cooperatives**
Institutional environment during the formation of modern agricultural cooperatives have a significant impact on the further development of organizational form, the peculiarities of its functioning and its ability for reorganization. As pointed out by Cook (1995, p. 1155), the reasons for the formation of an agricultural cooperative predetermine the duration of its existence. Decisions that founders take for the content of the main cooperative documents directly affect the allocation of property rights, management and control, and also affect the sustainability of organizational form (Van Bekkum and Schilthuis 1999, Eilers and Hanf in Cook, Chaddad and Iliopoulos 2004 , p. 80).

On this basis can be defined that the formation of a given cooperative depends on the motivation, as an expression of the main reasons that led members to join the cooperative, and the process of formation as an expression of fundamental contract conditions established by the founders of the new cooperatives.

The determination of the reasons for membership and establishment contracts in agricultural cooperatives requires an analysis and assessment of the institutional environment. Institutions influencing the decision to join a cooperative can be divided into formal and informal. The formal institutions includ regulations governing the implementation of land and structural reforms, the rules for the formation of new agricultural cooperatives, and all regulations associated with these processes. Existing informal institutions include customs and traditions of organizing farming through agricultural cooperatives, perceptions for the value of land, functioning of the markets, related to activities in the sector, availability of experience and knowledge and others.

As note Staatz (1989, p. 20), individuals decide to join the cooperative, if as a result of accession, they receive a greater benefit than would have brought any other alternative. I.e. analyzing the reasons for cooperation, should put the matter to the alternatives.

Economic realization of any asset set several alternatives to the owners: to sell the asset, to rent it; to engage in private business or to turn it into a joint business (either through equity or cooperative venture).

The decision to realization of an asset is influenced by several factors, main of which are: the market price of the asset, the subjective assessment of the owner for the value of the asset, access to information, the level of risk in the transaction, the stability of the banking system and macro-environment, traditions with regard to ownership and clearly defined property rights. Satisfactory level of these factors motivated the decision to sell an asset, and their unfavorable evaluation of the assets’ owners implies a choice of alternative. In this sense, unstable institutions (including vaguely defined property rights and unfair functioning markets) and resulting high transaction costs can stimulate membership in cooperative organizational forms.

Preferences for membership in the cooperative, except in cost-effectiveness may be rooted in some unique features of the organizational form, such as the combination of economic and social objectives, a higher degree of trust between participants, a sense of social and group identity among members , focusing on individual rather than on its capital and others. Despite
the importance of these cooperative features that in some cases outweigh the balance cost-benefits in the choice of organizational form, the economic reasons are leading to the decision to be involved in cooperative.

As mentioned above, the institutional environment can be defined as a network of formal and informal institutions that govern the behavior of individuals and organizations. On the other hand, these institutions can be grouped as political, market and civil. Combining these classifications and applying them to the conditions in Bulgaria may be offered the following scheme representing the elements of the institutional environment affecting the development of contemporary Bulgarian agricultural cooperatives (Fig. 1).

**Figure 1**

Institutional environment for the development of contemporary Bulgarian agricultural cooperatives
Characteristics of the institutional environment affecting the development of the Bulgarian Agricultural Cooperatives

The transition from a centrally-planned to market economy started in the early 90's of XX century, change substantially the functioning conditions of the agents in the economy as a whole and particularly in agriculture. Existing legislation proved inadequate to new conditions and needs substantial change. The way to implement this change in the field of Bulgarian agriculture starts with land and structural reforms launched by the Law on Ownership and Use of Agricultural Land (LOUAL) in 1991. This Act put the beginning of the process of recovering the private land ownership and liquidation of the inherited from the planned economy forms of organization of agricultural activity. As Mihailov (2001, p. 38) and Boyukliev (2004, p. 30) note, its consequences are extremely serious for Bulgarian agriculture. The main prerequisites for this are the destruction of old industrial organizational structures, without providing alternatives for their replacement, on the one hand, and the provisions of Art. 72 of the Heritage Act, which makes the existing serious problems with land consolidation. Admittedly of the Bulgarian agricultural economists, the decision was hasty and half-baked and predetermine the negative results of the agricultural sector for years to come. Law itself is defective, requiring many amendments (more than 30) as the last one is from 2009.

Liquidation of old organizational forms aimed at restoration of private property and the formation of new, unburdened by the past, adaptive and viable forms of organization, is accompanied by a minimum of five major problems.

First, the process of restoration of private land ownership appears much more complicated than expected, leading to its spread in an almost ten years period. According to the National Statistical Institute (NSI), the process ends only at 1999-2000, when the restored ownership rights over land reached 96.4% respectively for 1999 and 99.8% for 2000 from the specified recovery land for the country. During this period, agricultural land in Bulgaria, for the most part, have not real owner, in parallel, there are no longer cultivated it to the 1991 forms and creating new ones is hampered by unclear property rights and unstable economic situation in the country.

The second problem is related directly to the land owners. In most cases, the restored ownership of the land is covered by the heirs. This exhibit two negative effects: on the one hand crushing ground because of the increased number of owners, on the other - the process of entry into possession is additionally delayed due to partitioning procedures and trials. It should be noted that the majority of new land owners are completely cut off from agricultural activities, and often their home is a significant distance from the land of their inheritance properties. Additional restraining influence on the regulation of land relations have formed in the country very low prices of agricultural land, which discourage new detached from agriculture new owners to exempt of their land by selling it to potential entrepreneurs in the agricultural sector. The very search of land by entrepreneurs is also limited, making free land market in a virtually non-functioning institution.
The third major problem having an impact on restraining the development of agricultural production during the period is the lack of experience in selection and development of alternative models of organization of agricultural production. After the liquidation of old structures, the process of establishing new is left entirely to the operation of market mechanism and the expression of private initiative - elements that around half a century been oppressed in the Bulgarian economic life.

The fourth major problem is precisely the private initiative. As noted above, as a result of central planned economy at the start of agrarian reform in Bulgaria there is no informal institutional environment, supporting and developing private enterprise. On the other hand, the existing formal environment can be defined as a deterrent rather than stimulating entrepreneurship, since it is characterized by unstable macroeconomic, legal and credit terms.

A problem in targeting agriculture on a new path, resulting from application of LOUAL, create the release of a large number of agricultural specialists after the liquidation of old organizational structures. On the one hand, they have the knowledge and experience in the field of agriculture and can find the best implementation in it. On the other hand, the sector needs professionals who can initiate the formation of new organizational forms, from a third party - discharged from the old organizational forms specialists are routine in organizing and managing the existing to 1991 business structures.

Although ownership of land is recovered, it appears to be without economically active owners because of the process of urbanization took place and the transfer of labor from agriculture to industry. The state of macro-environment and economic returns in agriculture are not attractive enough to motivate the development of private enterprise on such a scale as to maintain full functioning of the sector. The distribution of the assets of the old structures in the form of individual shares makes difficult economic realization of that property.

Availability of agricultural specialists with experience in formation and managing a particular type of organizational form determines the demand for outlets for their knowledge and skills.

Additional element of the informal institutional environment underlying the formation of the modern Bulgarian agricultural cooperatives, is also the specific attitude of population to land ownership. A significant part of Bulgarian population, especially its older representatives, agrees that land is an asset that should not be sold, except in extreme circumstances. This concept, combined with unattractive conditions for starting their own farming activity guide preferences to the demand of collective land managing models.

These objectively existing factors, complemented by a new Cooperative law (CL) adopted in 1991, which stabilizes the formal institutional environment, regulates the formation and functioning of the cooperative organizational forms, and creates a more conducive informal environment for involvement in agricultural cooperatives by increasing confidence in them, are becoming serious prerequisites for the development of modern Bulgarian agricultural cooperative movement.
The newly adopted law on cooperatives continue longstanding traditions that the country has in the legal regulation of cooperative activity. This law and the lack of alternatives to new land owners, destined by the provisions of LOUAL, played the role of “a powerful legal incentive” (Ivanov 2004, p. 90) for the development of modern cooperative organizational forms. The Act was in force until 1999, when current CL is passed.

The going CL is estimated by experts as relatively good. It was created in cooperation with representatives of the International Cooperative Alliance (ICA) and the International Labor Organization (ILO), largely corresponds to the traditions of Bulgarian cooperative legislation, covers all the basic elements of cooperative matter and is written in accessible language. The law has a substantial influence on the direction of development of Bulgarian cooperative movement, but as every legal act, it has won a number of positive and negative characteristics and is periodically changed.

With last changes in 2003 concerning the definition of the cooperative, the law states that the cooperative may carry out social and cultural activities to satisfy the interests of its members. This create wider opportunities for development of cooperative activities and reflect latest developments in the world cooperative movement, which increasingly are entering the so-called social cooperatives. The newly adopted rider focus on the social aspect of organizational form, which can be seen as an attempt by lawmakers to influence informal institutions by introducing formal regulation.

Such a positive opportunity, however, has not been used in relation with the types of cooperatives. Moreover, in this respect is compromised relatively good continuity between existing beyond the period of centrally planned economy cooperative laws. As some authors state (Trenev et al. 2001, p. 32-33) the Act of 1907 outlines the basic types of cooperative activities and standard operating conditions applied in these cooperatives. Such a practice is maintained also in the laws of many developed countries, but is not reflected in current regulations on the activities of cooperatives in Bulgaria. This determines the lack of diversity in modern Bulgarian cooperative system and the development of primary production cooperatives, similar to these from the period of centrally planned economy.

Contradictory at first glance is the legal regulation concerning the cooperation between cooperatives. In the modern law of the cooperative unions were given an opportunity to engage in business activities, which often go beyond the economic objectives of the individual cooperative. Although yields essential function in providing assistance and guidance of cooperative activity, it is made to ensure self-support of organization. Regulation can be reported as positive in view of the fact that is consistent with the specifics of the institutional environment in modern Bulgaria.

Not so is the issue, however, with the regulation that inter-cooperative companies can be organized as sole limited liability companies, sole shareholder companies, but not as cooperatives. As the Kovacheva note (2000, p. 174), there is no logical explanation of this regulation as it is inherently restrictive. In this way is limited ability of cooperatives to join at a higher level to produce and trade and as a cooperative organization to participate more
widely in certain markets and to influence them, as is the practice in countries with developed market economy. The practical consequence of this regulation is that the modern Bulgarian agricultural cooperatives are mainly primary and cooperation to a higher level, as there exist is formal.

Public significant social functions of cooperatives and specific mode of operation make them warranted a number of preferences to them. Such incentives were provided for by law solely for the creation, reorganization, dissolution or liquidation of cooperatives. With amendments to the law in 2003, the state can support and encourage co-operatives in their work under conditions and procedures specified in the relevant special laws. None, however, clear regulations on what conditions and in what amounts the state will encourage and support cooperation, which does not stimulate the development of organizational form and the promotion of social functions.

Characteristic of the Bulgarian Cooperative law is the requirement the cooperatives’ property to be divided into financial shares to their members. The logic of the legal norm is rooted in the desire to justify the investment activity of the cooperative members. It is believed however, that this provision conflicts with the openness of the cooperative (Kovacheva 2000, p. 175). The main problem comes from the characterization of the cooperative as an organization with a variable number of members and variable capital. Thus, the requirement of law for the distribution of all assets in property shares is a prerequisite for financial instability of the cooperatives. The decision should be sought in a differentiated approach to legal standards for different types of cooperatives, consistent with their essential characteristics, which was lacking in current law.

Specific are also the regulations of the law regarding land relations. Under the provisions, the cooperative can not own land. Organization can use the land of members and non-members based on rental agreements and lease. Logical explanation of the meaning of the rule of law is the legislature's desire to protect land owners, to reduce conflict situations in the annual fixing of rent payments and crop-rotation areas and to facilitate management by reducing the membership on behalf of members participating only by land in the cooperative. This condition, however, puts cooperatives in a disadvantageous position compared to other organizational forms that are not limited to the purchase of land and the expected positive management effects are not given practical realization.

Kaneva (2001, page 4) consider the right to purchase land from agricultural cooperatives so as to ensure its stability. This formulation of the law, however, prevent the formation of the common cooperative funds in accordance with the object of activity, since for the predominant type in Bulgaria (agricultural production cooperatives), this is precisely the cooperative land fund and the formation of such a fund allows both stabilization of organizational form and the natural course of land consolidation.

The existence of a separate law on cooperatives, which essentially sets the framework in which cooperative organizations operate, does not exhaust the characteristics of the formal institutional environment for development of cooperatives. Important for the successful
development of a cooperative is integration of the specific role and capabilities of the
organizational form in the legal regulations of many different elements of socio-economic
76-102, 345-352) and subsequently treated 21 law, which more or less are able to influence
the development of cooperative organizational forms.

This examination shows that 67% of cases, laws do not provide opportunities for application
of the cooperative form of business management in the field. To this group belong the Water
Law, Law on associations for irrigation, the Forestry Law, the Law on Protection against
Unemployment and Promotion of Employment, the Regional Development Act, the Law on
consumer protection and trade rules, the Law on Protection of Competition, Livestock Act,
the Tourism Act and others.

Especially paradoxical is the absence of such rules into laws, which regulations include
essential to the cooperative organizational form characteristics, and provide opportunities to
carry out activities through it. A typical example in this respect is the law on associations for
irrigation, in which by definition the irrigation associations are distinguished by minimal from
cooperatives - members of the irrigation associations can be entities and they have
proportional voting rights. But it should be noted that international cooperative practice
already allows the participation of both entities, and proportional voting in certain cases.

Cooperatives are a type of organizational form, which traditionally plays a significant role in
economic and social development of regions. The importance of this role can be assessed by
the fact that in many countries and research are made experiments with the possibility of
transferring some of the social functions of the state over the cooperatives. In the Bulgarian
Law on Regional Development, however, this role is not taken into account.

Likewise is omitted the ability of cooperatives in achieving the purposes of the livestock act.
Cooperative organizational form is often used by individual farmers to carry out activities that
are not within the reach of individual works, such as breeding and selection work, which is
not covered by law.

In 33% of the examined laws there are specific regulations on cooperatives, but this does not
mean that in one third of cases cooperatives have a favorable legal interpretation. A typical
example of the unfortunate decision of the lawmakers is the regulation of the Law on tobacco
and tobacco products, which enables production to be carried out under the cooperative form.
It is known however that the main problem of tobacco producers is not itself manufacture, but
is a speculative pressure on the market purchase prices of the resellers - a problem that can be
overcome through policy, promoting the development of marketing rather than production
cooperatives.

As not very adequate is assessed by professionals (Pelova et al. 2002, p. 78-79) also the
regulation of Art. 67, para. 1, item 5 of the Law on wine and spirits. According to it by
proposal of the National Vine and Wine Chamber, Ministry of Agriculture and Forestry
through the Agriculture State Fund may finance the creation of wine cooperatives and
associations. As the authors note this put wine cooperatives into state custody and depending on large capital companies in the industry, thereby limiting free will and interests of small and medium owners of vineyards and producers of wine and spirits.

**Conclusion**

In summary it can be noted that from a formal point of view, a significant influence on the process of formation and development of contemporary Bulgarian agricultural cooperatives had mainly the Law on Ownership and Use of Agricultural Land and Cooperative Law.

LOUAL and implementation of the structural reforms pose the society to unspecified property rights, destroyed organizational forms, malfunctioning markets and unstable macro-environment, which implies the absence of reasons for initiating the individual business.

Adopting a new law on cooperatives focuses on cooperative, increased its credibility and becomes a stimulus for the formation of such organizational forms. Shortcomings of the law, however, occurring mainly in inadequate regulation of financial control, lack of flexibility in terms of organizational structure, omission to reflect some new forms of funding of cooperative activities and the lack of differentiated regulations for different types of cooperatives, predetermine the uniformity of contemporary Bulgarian agricultural cooperative movement and instability of the organizational form.

From an informal point of view, the main factors which determined the development direction of today's Bulgarian agricultural cooperatives are limited to the existing tradition in the production cooperation, knowledge and experience of agricultural professionals, lack of knowledge, experience and entrepreneurial initiative in the new owners of agricultural assets and others.

In conclusion it may be noted that improving the functioning of the Bulgarian agricultural cooperative movement requires substantial changes in the institutional environment. Significant change in the parameters of the economic system requires the implementation of changes, both in formal and in informal institutions.

In terms of the speed of change in institutions, it is advisable to adopt such formal parameters of the institutions that influence the direction of change of informal bodies. In this case, special attention should be paid on the promotion of: individual entrepreneurship; various types of cooperatives, supporting the activities of individual farms and social functions of the cooperative. The institutional changes have to comprise the creation of opportunities for clear definition and protection of the property rights; establishing of external mechanisms increasing the control in the co-operatives; improvement of the cooperation among the co-operatives and last but not least purposeful state policy for training of the agricultural producers for clarification and popularization of the main point, the possibilities and the limitations for the application of diverse, functional and non-political co-operative organizational form in the contemporary Bulgarian agriculture.
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