



DEVELOPMENT OF AGRICULTURAL COOPERATION IN ARMENIA: NEEDS ASSESSMENT

Yerevan, 2017

Introduction

This paper is based on the data and findings produced in frames of a comprehensive study on Cooperation between Agricultural Producers in Armenia implemented by Mosaic A-M LLC in summer 2016, and on follow-up expert interviews conducted in November 2016.

The paper outlines the reasons why fostering agricultural cooperation in Armenia is prioritized by policy makers, community development organizations and donors, takes a closer look at past and ongoing projects in terms of lessons learnt, and concludes with needs assessment, which intends to assist Shen NGO and other stakeholders in designing future interventions as well as calibrating ongoing projects with a view to improve the efficiency and sustainability of agricultural cooperatives.

We express our deep gratitude to the experts who kindly agreed to share their insights that are reflected in this paper:

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- Karen Torosyan, Coordinator of Component 1 of CARMAC Project, Agricultural Projects Implementation Unit
- Sergey Matevosyan, Head of UNIDO Component, ENPARD Armenia
- Husik Sargsyan, Head of Economic Development Projects, World Vision Armenia
- Armen Khalatyan, Coordinator of Agricultural Projects, UMCOR Armenia
- Vardan Urutyan, Director, ICARE Foundation, co-author of the Law on Agricultural Cooperatives
- Hayk Minasyan, Chairman of the Board, Shen NGO

Part 1. Background and rationale: why focus on agricultural cooperation and what has been done so far?

The collapse of the Soviet Union had a drastic impact on the Armenian economy at large, and on agriculture in particular. The majority of agricultural lands were privatized and the Soviet era agricultural cooperatives (or state-owned collective economies) were no more. Close to 340,000 private farms that were created as a result had no supporting infrastructures, such as appropriate agricultural machines and equipment, irrigation water supply or access to advanced agricultural practices.

According to the World bank study of 2007, each private farm had 1.4 hectares of land on average, including just over 1 hectare of arable land. Due to high level of emigration from rural communities, it was estimated that the number of farms had dropped to 200,000.

Nonetheless, agriculture remains the second largest sector of Armenia's economy with estimated 17.3% share of the nation's GDP and providing close to 35% of all jobs in the country in 2015. With very limited sources of alternative income, rural population heavily relies on agriculture to earn a living.

Despite the efforts of the government and the donor community, agriculture remains one of the most vulnerable sectors of the Armenian economy with numerous issues and challenges, including, but not limited to:

- Small, fragmented land plots
- Lack of appropriate agricultural infrastructure, in particular new (or at least operational) agricultural machines and equipment, processing and storage systems
- Lack of access to high quality agricultural inputs – seeds, seedlings, pesticides, fertilizers, fuel, as well as specialized agronomic services
- Low level of awareness and skills of application of modern agricultural methods and technologies
- Insufficient support infrastructures, such as irrigation and roads
- Underdeveloped market infrastructure
- Lack of individual farmers' capacity/leverages to protect their rights
- Lack of access to low-cost financing
- Unavailability of disaster insurance schemes.

Considering the nature of existing issues and the best international practices of dealing with these issues, there is an overwhelming agreement among the experts that fostering agricultural cooperation is vital for overall development of the sector and for improvement of livelihoods of individual farmers.

Among the many benefits of agricultural cooperation, the experts pointed out:

- **Increased income from agriculture** by way of cost reduction (procuring agricultural inputs at wholesale prices; joint organization of the cultivation cycle, harvest and post-harvest activities, transportation, etc.), improved quality and quantity of produce (access to appropriate agricultural machinery and higher quality inputs), as well as better access to the market (bigger volumes of produce are easier to sell to a variety of wholesale buyers; higher negotiating power with the buyers).
- **Improved access to technical assistance**, such as trainings and consultations to get acquainted with advanced agricultural technologies, explore new product and market opportunities, and develop a business mind-set in general.
- **Better access to financing**, primarily to state and donor funded projects, because private financial organizations currently do not have tailored products for agricultural cooperatives (more on this in Part 2).
- **Job creation** – with increased volume of production and sales, farms will be incentivized to expand and engage more workers. Besides, the cooperatives themselves provide jobs to their administrative staff.
- **Ability to advocate for farmers' rights** and collectively lobby for assistance policies and actions, such as improvement of relevant legislation, or rehabilitation of support infrastructures on community level.

With this in mind, the last decade (and the past few years in particular) has been marked by increased attention from both the government and the donor community to promoting agricultural cooperation between individual farmers, mainly by way of supporting the establishment and development of so called Consumer Cooperatives, that are in essence non-profit agricultural cooperatives.

As of January 2015, around 400 consumer cooperatives have been registered in Armenia. Almost half of these (around 180) were established in frames of the World Bank financed Community Agricultural Resource Management and Competitiveness (CARMAC) project alone. The project is now in its second phase and is managed by Agricultural Projects Implementation Unit, a state agency under the Ministry of Agriculture. The cooperatives, called “Pasture User Unions,” are supported in frames of CARMAC’s Component 1: Community/Pasture Livestock Management System.

The majority of the remaining consumer cooperatives have been established with support of other donors, such as UMCOR, World Vision, Oxfam, Positive Planet and Shen. These have various profiles and represent production as well as processing sub-sectors.

Increased focus on agricultural cooperation by the government is evidenced by the creation of a specialized Division for Assistance to Agricultural Cooperatives within the Ministry of Agriculture. The division was established two years ago and aims at creating a favorable legislative framework for the cooperatives, as well as acting as an information hub for cooperatives and donors.

In terms of legislative reforms, the most significant step so far has been the adoption of the Law on Agricultural Cooperatives in December 2015. Formerly, the cooperatives were largely governed by the Law on Consumer Cooperatives, which defines them as non-profit entities. In contrast, agricultural cooperatives are for-profit entities, a model that is considered more appropriate in terms of sustainability and economic efficiency. The Law on Consumer Cooperatives is still in force, and farmers (and donors) can still choose between profit and non-profit models based on the specifics of their activities and perceived benefits of each scenario.

Since the adoption of the new Law, 54 agricultural cooperatives have been registered, 53 of which were created with support of the European Neighborhood Programme for Agriculture and Rural Development (ENPARD) that launched in Armenia in 2015. The project supports producer groups which are involved in the production and processing of the selected value chains, in particular, of high value field crops such as buckwheat, high value cheese, dried fruit and herbs, high value and non-traditional vegetables, berries and fruits.

Despite the efforts made so far, the experts shared a concern that the majority of existing consumer cooperatives fail to function effectively and are “cooperatives” only on paper. The question then is: why do some cooperatives succeed while others fail?

As to the newly registered agricultural cooperatives, all of them, in fact, have filed requests to temporarily cease all activities due to substantial concerns regarding the new legislation, which poses a question of why this might be the case.

Part 2 tries to explore these issues by looking into the lessons learnt from some of the major completed and ongoing projects.

Part 2. Lessons learnt from past and ongoing projects: what makes or breaks cooperatives?

The experts agreed that by far the biggest challenge they have faced in their projects was what is referred to as “**soviet mentality**” or “collective economy mentality.” While younger generation of farmers (the minority) do not carry the burden of this experience, the term “cooperative” is perceived by the majority of farmers as the reincarnation of the state-owned, state-controlled totalitarian structure, where members don’t have any say in decision-making and have no ownership over assets or outputs. This creates an environment where attitudes and behavior patterns of the past, which contradict the very ideology of agricultural cooperation, transfer over to the present. To achieve any success at all, the donors are therefore tasked with a difficult mission of “unteaching” the old and teaching the new.

Breaking social stereotypes and changing behavior patterns is not something that can be accomplished in a short period of time. This is why the experts were unanimous in their conviction that one of the most common reasons why many cooperatives established within the last 10 years have failed was that **donor projects were often bound by unrealistic deadlines** that led to them being **output rather than outcome oriented**, i.e. create an X number of cooperatives and provide them with Y amount of assistance, all usually within 2 or at most 3 years. Once the projects were completed and the donor presence withdrew, the cooperatives disintegrated or transformed into a “one-man-show.” In contrast, some of the best success stories are observed in cases where donors took a more long-term approach, assisting and monitoring the cooperatives for a number of years.

Choosing the correct type of assistance as well as **determining the optimal level of donor involvement** are of crucial importance as well. Over the years, donors have experimented with various kinds of assistance. Most commonly, the assistance was in the form of co-financing the purchase of agricultural machinery and provision of technical assistance, i.e. trainings and consultations. While both of these types of assistance are considered necessary, the experts agree, however, that when it comes to procurement of assets, the **required level of investment by the cooperatives is oftentimes very low** (averaging about 25% of the total required investment). This is because the majority of the cooperatives have a nominal membership fee of 1000 AMD (about 2 USD), which allows them to attract low-income groups, but makes it impossible for them to make any tangible contributions. The experts observe that **in cases where membership fees are somewhat reasonable** (50,000 AMD or about 110 USD) **the cooperatives are much more sustainable**, because the members are significantly more motivated to participate in decision-making processes and have a much bigger sense of ownership.

As to the level of donor involvement, the best way to sum up the experts’ opinions is “**assist, closely counsel and monitor without intervening**.” What this essentially means is that donors should help the cooperatives make informed decisions, but refrain from making decisions for them.

Closely linked to decision-making process is **the extent to which the cooperatives are governed by democratic principles and participatory approach**. The experts feel that one of the important reasons why some cooperatives fail while others succeed is that in

some instances the elections of the cooperatives' boards are not transparent and/or the results are predetermined, the cooperatives are *de facto* controlled by the village administrations (in many cases the village mayors or their close relatives are chairing the cooperatives) and members have little or no interest in participating in decision-making.

This has a lot to do with the above-mentioned "soviet mentality," but also with what some experts refer to as "**human factor**," i.e. how influential/respected/trustworthy the village mayor is, and how well-intentioned/capable/visionary he or she is. The experts agree that cooperatives tend to be more successful with constructive rather than destructive-minded local government and that it helps to create amicable relations between the cooperatives and the village administrations. At first glance this seems like a trivial statement, but the very fact that success or failure of a cooperative at any given time is influenced (to a small or a large extent) by the personality of the incumbent village mayor is troubling for many obvious reasons. While the donors cannot control this "human factor" in any way, some of them have put in place policies that restrict direct involvement of the village administration in governing bodies of the cooperatives. Among other methods of dealing with the issue, as well as to promote democratic principles in general, some donors have dedicated staff that attends the general meetings of the cooperatives and elections of the board members, as well as requires that the cooperatives publish their decisions thus making them available to all members and the general public.

The "**human factor**" extends beyond relations between the cooperatives and the local governments and **is manifested in the relations within the cooperatives** as well. The experts thought that much of the cooperative's success is still determined by how well its members trust and get along with each other and with the cooperative's board on a personal level.

Another lesson learnt from previous projects that perhaps suggests a partial solution to some of the above issues is that "**bottom-up**" **approach yields more success than "top-down" approach**. What we mean by this is that many experts believe that significantly bigger progress can be achieved when small groups of farmers are formed **around the idea** and the perceived benefits of cooperation, build necessary capacity, develop and start implementing a business plan with support from the donors, and then decide whether they want to formalize the group and what legal status they deem most suitable. In contrast,

when cooperatives are formed **around a tractor** or some other form of immediate material incentive coupled with donor requirement of registration of a legal entity and a minimum number of members, the risks that the somewhat artificial structure will sooner or later collapse become much more substantial.

Another major issue that stands in the way of sustainability of the cooperatives is that **only a tiny fraction of them have reserve funds in place** that can be used to repair agricultural machinery, acquire new assets or make any other investments they might deem necessary. Again, this is rather understandable given the insignificant levels of member investment. However, some of the experts are convinced that while farmers currently lack certain basic skills necessary to effectively run a cooperative, “they are not dumb, if they know that an investment of 50,000 AMD is going to lead to them having 300,000 more profit, every single one of them is going to make that investment.” Perhaps a valid counterargument could be that many of the small-scale producers simply can’t afford this investment, however reasonable it might seem.

While this may be true, the issue itself should not deter cooperatives from making economically justified decisions that lead to sustainability and higher profits in the long run. Instead, **financing schemes available for cooperatives and their individual members need to be strengthened**. Some donors have had experience in the past of providing zero interest loans to the cooperatives, which were then disbursed as low-interest loans to the members, with profits then being used to fund the cooperative’s activities. This scheme, however, could no longer be practiced by the donors ever since the Central Bank introduced regulations stipulating that only accredited banks and universal credit organizations could offer loan products of any kind.

Desk research conducted in frames of Mosaic A-M’s study on Cooperation Between Agricultural Producers in Armenia demonstrated that even though the volume of provided agricultural loans has been steadily increasing over the past ten years, the **actual interest rates vary between 12% to as high as 70% annually**, and that there are currently **no tailored loan products for agricultural cooperatives**. While financial organizations believe high interest rates are justified from a risk management perspective (agriculture not being insured and being highly susceptible to natural disasters and market risks), the very

fact that the loans are so expensive, in fact, increases the risk of farmers not being able to pay them back.

Finally, to the matter of why the newly established Agricultural Cooperatives chose to temporarily freeze their activities immediately after their legal registration, the experts agree that while the new **Law on Agricultural Cooperatives** was a step forward in the right direction, it actually **has some serious flaws**. While comprehensive legal analysis is beyond the scope of this paper, the experts agreed that the most problematic aspect of the Law is that it doesn't make any distinctions between *surplus* that is generated by the cooperative through its dealings with its members and *profit* that is generated from any commercial dealings with third parties. The legislation therefore puts agricultural cooperatives in the same taxation framework as any other for-profit entity. Resolving this issue requires amendments to the Law on Agricultural Cooperatives, but also to the Tax Code. This and other relevant changes to the legislation have been proposed to the government by several donors and are currently being discussed.

Meanwhile, organizations that have supported the establishment of consumer cooperatives (including the Agricultural Projects Implementation Unit) said they had no intentions of facilitating their transformation into for-profit agricultural cooperatives in the near future, or at least until the issues with the new legislation are resolved.

Part 3. Needs assessment

Taking into account the lessons learnt from previous and ongoing projects, the experts' direct recommendations, as well as the findings of the study on Cooperation between Agricultural Producers in Armenia, below is a list of priority needs that the government and donors should address in order to improve the efficiency and sustainability of agricultural cooperatives.

- **Awareness raising among farmers regarding forms, benefits and ideas behind agricultural cooperation.** The farmers need to make a well-informed decision to create or join a cooperative, be motivated to contribute to its growth and be able to set realistic expectations. They need to be well-aware of rights and responsibilities associated with membership, as well as opportunities and possible challenges. Almost all past and ongoing projects incorporated an awareness raising component

to a degree allowed for by the available funding. In most cases this was limited to a few introductory sessions with farmers of target communities. Some projects, however, planned and implemented much more extensive campaigns involving, for example, production of a series of short films that were then broadcast on local TV channels for general public. Involving representatives of successful cooperatives in introductory meetings with farmers is also considered a very effective tool. For the awareness raising campaigns as well as for trainings provided to the already identified groups of farmers or registered cooperatives (more on these training needs below), the donors must recruit highly qualified experts of respective fields and/or organize train-the-trainers events to equip the staff working with the farmers with necessary skills and expertise.

- **Trainings for established farmers' groups or cooperatives.** These should include modules on business planning, financial management, accounting, legal framework, marketing, buyer relations, negotiations, and team work. The trainings should be based on "learning-by-doing" approach and contain as little theory and as much practice as possible. For example, the expected result of the business planning module should be an actual business plan prepared by the members themselves. Additionally, as practiced by several donors, hands-on training and consultations should be provided on topics identified for each individual case, such as advanced technologies of cultivation of specific crops, operation and maintenance of agricultural machinery, etc.
- **Financial assistance.** It is clear that in their infancy, the overwhelming majority of cooperatives need financial support in acquiring a sufficient number of high quality equipment and machinery. At the same time, it is crucial for public and private donors to ensure that external financial support is reduced to a minimum necessary level, so as to encourage the members of cooperatives to make personal investments in cooperative's assets and/or purchase assets using the reserve funds of the cooperative. This will help foster sustainability, ownership, increased participation in cooperative's activities and departure from the Soviet mentality of an externally controlled entity with no self-sufficiency.

- **Assistance in accessing markets.** In the start-up period, the farmers' groups or cooperatives need practical assistance in identifying markets and buyers, as well as in closing actual deals. This does not mean the donors should routinely close deals for them. They might, however, commission market studies, provide business leads, consult the farmers on how to approach the buyers and negotiate favourable deals. They could also take part in the first few negotiations (as practiced by some donors) to set them on the right foot, as well as give practical feedback and further advice. Additionally, the donors can encourage and help cooperatives get represented in various agricultural Expos.
- **Long-term donor presence.** Due to lack of appropriate skills and experience, limited financial resources, as well as most importantly the attitudes and stereotypes inherited from the past, the cooperatives have to traverse a long road to achieve self-sufficiency and sustainability. They therefore need prolonged assistance (even if only in the form of consultations) and monitoring from the donors that can be provided through regional representatives or other dedicated staff. Over the course of work with the cooperatives, the donors should identify issues that prevent the cooperatives from operating efficiently, bring the issues to their attention, and provide advice on possible solutions without directly interfering in the internal management and decision-making processes.
- **Quality over quantity.** The experience shows that cooperatives with large membership base (often imposed by donors' minimum requirements) are not necessarily the most successful. Quite to the contrary, the majority of experts believe that it's the small groups of sufficiently motivated farmers gathered around the right ideology that usually achieve the best results. Therefore the need in this sense is for cooperatives to not be bound by any membership quotas and have the freedom to accept and revoke as many memberships as they deem fit, based on the level of participation, motivation and contribution of potential and current members. The "quality over quantity" approach should be equally applied in determining the number of farmers' groups or cooperatives that the donors should work with. Our general recommendation in this sense is to focus efforts and resources on a small number of carefully selected beneficiaries and closely work

with them until they become sustainable. This will generate a bigger number of success stories and help promote the ideas of agricultural cooperation among farmers at large.