

Doctoral Thesis



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**The Political Economy of Agricultural Cooperatives in Bosnia  
and Herzegovina: Towards a Sustainable Rural Development  
Model**

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Samira NUHANOVIĆ – RIBIĆ

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Advisor: Prof. Ermanno C. TORTIA  
Università degli Studi di Trento

Doctoral Committee: Prof. Silvio GOGLIO  
Università degli Studi di Trento  
Dipartimento di Economia e Management

Dott. Michele MOSCA  
Università degli Studi di Napoli  
Dipartimento di Scienze politiche

Dott.ssa Marina ALBANESE  
Università degli Studi di Napoli  
Dipartimento di Scienze politiche

*To my son*



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# Abstract

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Agricultural cooperatives emerge as tools through which individual farmers meet their economic and social needs and they do so in a manner that allows them both to economize on costs and to disperse the risks associated with pursuing these needs individually. They are particularly useful for enhancing economic development of transition countries in which basic market economy infrastructure is either underdeveloped or is altogether missing. However, agricultural cooperatives do not always deliver the desired level of rural development. Although the literature sometimes takes this to mean that the model itself is defective, I argue to the contrary. In this thesis, I propose that it is the evolutionary path of cooperative idea, its implementation in reality and the way in which it interacts with its institutional surroundings that condition the ability of the model to perform. In other words, cooperative idea is not immune to its political and economic context but rather it is molded by it, and sometimes to the point that it no longer resembles its original substance.

In line with that, the main objective of this thesis is to look into factors that either stimulate or discourage development and functioning of agricultural cooperatives in a context of post-socialist and post-conflict Bosnia and Herzegovina (BiH). In doing so, the thesis adopts a new institutionalist frame of analysis combining it with the insights from the economics of the third sector and the cooperative theory to highlight both the evolutionary nature of cooperative idea as well as its embeddedness in the socio-economic context. The research relied on quantitative and qualitative approaches and gathered data from field work and secondary sources.

The main findings can be summarized in the following several points: both formal and informal institutions have shaped the way in which cooperatives are understood and utilized by farmers in BiH; cooperatives in post-socialist and post-conflict settings require legal clarity that not only sets them apart from other types of firms in the market but also from degenerated forms of cooperatives that exist to serve interests of few individuals rather than cooperative members and their communities; when judged by the standards that apply to cooperatives in economically advanced societies, it is safe to state that there are very few true cooperatives in BiH; given the structure of agricultural market and number of farmers, there is a lot of potential in utilizing the cooperative model for purposes of rural development. However, using cooperatives for development purposes requires a basic alignment between the features of institutional environment and cooperative organizational characteristics. If stimulated properly through positive policy changes, cooperatives can exhibit transformative potential that is best reflected in how they empower their patrons as well as contribute to the development of their communities.

**Keywords:** cooperative identity and performance; post-socialist context; participatory governance; rural development, member-nonmember dynamics.

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# Introduction

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In the course of the twentieth century and across the globe, cooperatives have grown in numbers, their market share has increased and their overall impact on members' and communities' well-being is now being properly acknowledged. This is particularly true for agricultural cooperatives. And this is immensely important in the move beyond market fundamentalism (Stiglitz, 2009) and towards more solidarity oriented economy that favors peoples' long term well-being over short term profit seeking behaviour of capital owners (Birchall, 2010). However, despite their growing importance worldwide, their documented ability to resist the effects of the recent global financial meltdown (Birchall and Ketilson, 2009; Münkner, 2012) and their general adequacy in building solidarity-driven local economies (Bateman, 2013) especially in underdeveloped societies deprived of strong social ties, cooperatives are still neither dominant nor preferred organizational form in many developing countries. Bosnia and Herzegovina (BiH) is no exception to this.

Being a post-socialist, post-conflict and transition state, BiH's many political challenges have found their way into cooperative sector where they navigate the public sector discourse away from exploring development potential of cooperative model and towards further stigmatizing cooperatives as inefficient enterprises. This makes the study of political economy of cooperative sector in BiH a necessary step in understanding the coming about of currently prevalent cooperative model, its relation to past and present institutions, and its potential role in instigating development of local rural communities in BiH and consequently its ability to affect a larger institutional change across the country.

Additionally, the institutional and systemic changes that marked the break up of Yugoslavia in the early 1990s and gave rise to a number of independent states, including BiH, provide an interesting analytical context to observe the interaction between various agents that help shape new institutions through internationally supervised democratization and liberalization processes that are still taking place in BiH.

Within such context, this thesis explores the general conditions of cooperation in agricultural sector of BiH with a focus on ownership and governance characteristics of agricultural cooperatives. It does so by analyzing institutional and organizational factors that affect cooperatives' economic and social performance. The main focus is on evaluating firstly, the capacity of cooperative model to serve as engine and instrument of locally focused rural development in BiH, and secondly, on scrutinizing the institutional and organizational conditions that can drive the cooperative development model up the policy agenda. To that aim, this thesis questions the dynamics and interplay between past and present institutions focusing

especially on their legal dimension pertaining cooperative sector, and it explores how the complex network of institutions interacts with currently existing cooperative models. Studying these interactions and relations is quite revealing of significant and substantive incompatibility between what is historically and commonly understood to be a true cooperative model in more economically advanced countries and what is dominantly practiced in BiH cooperative sector. The challenges faced by agricultural sector in BiH, including its agricultural cooperatives, mirror a significant interconnectedness between political and economic institutions, which is in turn reflected in ownership and governance structures of collective action organizations. Hence, the political economy of agricultural cooperation is central to this study.

This thesis brings together insights from different scholarly traditions in a multidisciplinary framework in order to explore, analyse and explain the meaning of and conditions for development oriented cooperation among farmers in BiH. To that end, the framework of analysis presented in the first chapter outlines a conceptual structure through which this thesis will, chapter by chapter, recall insights from the New Institutional Economics (NIE), more specifically its transaction cost and property rights approaches, draw on various views from the third sector economics, rely on intuitions from social capital and networking perspectives, as well as integrate contributions of economic sociology and political economy into a wider framework of this research.

The plurality of perspectives that informs the analysis presented in this thesis reflects a number of research questions asked throughout the thesis but also specific limitations of what are thought to be the mainstream approaches in economics in explaining the emergence and functioning of agricultural cooperatives. To compensate for the shortcomings of individual approaches and to account for the complexity of the issue at hand, I attempt to bring different perspectives together into a research structure that inquires both about endogenous and exogenous barriers to cooperative development in BiH. Furthermore, given the political and economic context of BiH, as well as its past socialist experiences, I ask how currently dominant cooperative model can be reconceptualised so that its interaction with local government bodies yields economic and social development of communities. More specifically, I look into what particular changes both in cooperatives' internal structures and in their public policy environment could best promote development potential of cooperatives.

In a more general sense, this thesis investigates the relationship between institutions, agricultural cooperatives and development in the context of BiH's defective democracy, to borrow a political science term. An underlying premise that informs this approach rests on the claim that direction of causality between institutions and economic development is difficult to determine. And determining it may require a detailed reference to contextual variables that best describe the interaction between various structures within a society.

Even though the general discourse on the importance of institutions to economic development is not new, the debate on the direction of causality between the two has attracted a lot of scholarly attention recently. The views range from ardent supporters of arguments that treat, especially empirically, institutions as fundamental determinants of long run growth and development (Acemoglu et al., 2005) to those who challenge the mainstream discourse on the account of its theoretical simplifications and selective treatment of empirical evidence pointing that in fact the causality runs in the opposite direction (Chang, 2011; Dutt, 2011). The middle ground between the two standpoints is occupied by those who propagate the 'co-emergence' of institutions and development and call for discussion to shift towards focusing on institutional performance rather than debating supremacy of institutions over development or vice versa (Brouwer, 2011).

To this generalist debate the thesis adds a consideration that perhaps dynamics between institutions and development differs across sectors and to that end it offers an argument that certain specificities of agricultural sector and rural areas in particular shed a new light on both process and content of interaction between institutions and development. Indeed, for a number of reasons specific to agriculture markets have shown to fail in this sector even if they function relatively well in other sectors (Stiglitz, 1987). Additionally, this thesis will propose that the relationship between institutions conceptualized as norms, values and rules of behaviour on the one hand and development on the other may depend on the characteristics and organizational values of the agent through which institutions 'interact' with members of society. Acemoglu et al. (2005: 386) make an argument that "differences in economic institutions are the fundamental cause of differences in economic development". The path need not be so straight forward and may need to account for the characteristics of agents in charge of 'translating' the institutions to development or vice versa.

In the light of this and for the purpose of exploring development potential of cooperatives in BiH agriculture, this thesis adopts a broader view of the relationship between institutions and development, allowing for sector and context specific forces to shape the interaction. Consequently, crucial to understanding the dominant cooperative model in BiH is recognition of its historical evolution as well as current uniqueness of economic and political space in BiH affecting development dynamics of agricultural sector. That is why at the outset the thesis gives an account of historical background of cooperative idea on the territory of now post-Yugoslav space starting from 19<sup>th</sup> century, when first cooperatives were formed, and onwards following the evolution of the model through political and economic changes of the 20<sup>th</sup> century. The point of presenting a historical overview of cooperative movement in the region of former Yugoslavia is not an attempt at quantification of the magnitude and depth of relationship between informal and formal institutional environment, for that in itself is a huge research

endeavour. Instead, due to well recognized embeddedness of cooperative enterprise in its socio-economic setting, the historical overview serves to account for possible presence of path dependency mechanisms in agricultural sector, and more specifically in cooperative sector.

Accordingly, the existing legal structure that regulates agricultural and cooperative sector will not be taken as historically sterile. On the contrary, it will be viewed in the light of its evolutionary path and taking into account the mechanisms through which norms and values of previous regimes were more or less silently transposed onto the current cooperative model in BiH. In an attempt to objectively assess whether the institutional environment in BiH acts as a deterrent or a catalyst for cooperative and rural development, a special chapter will be devoted to the analysis of legal framework and policy instruments that directly or indirectly affect agriculture and cooperatives in BiH. Within that framework, the thesis will introduce the concept of 'local developmental state' (Bateman, 2013) as a possible way of getting around institutional obstacles to fostering cooperative values and principles and invigorating the strategic role of state institutions where this makes most sense for cooperatives – at the local level.

Furthermore, the thesis discusses the internal organizational features of agricultural cooperatives in BiH in the light of their present and potential role in instigating development of rural areas in BiH. The types of cooperatives, their level of specialization, propensity towards vertical and horizontal integration among them, the role of associations of cooperatives and cooperative directors will all be examined with respect to their influence on the status and success of agricultural cooperatives in BiH. The thesis will look into how the existing internal structures match with the proposed policy instruments for rural and cooperative development.

Moreover, the thesis analyses variations in organizational forms of agricultural cooperatives in BiH paying special attention to different organizational deviations from the traditional cooperative model in an attempt to explain the prevailing perception of cooperatives in BiH as inefficient enterprises and outdated business model. In doing this, the thesis recognizes the value of arguing for a greater scholarly recognition of both 'cooperative advantage' and 'cooperative difference' (Birchall, 2003; 2013; Novkovic, 2008) in diversifying cooperatives from their counterparts and measuring their performance accordingly. To add to this argument, the thesis maintains the position that properly understanding the essence of cooperative advantage is a way of constructing or rather reconstructing cooperative identity in post-socialist and post-conflict context of BiH. This, in turn, translates into one of the main objectives of the thesis and that is to probe the relationship between 'cooperative difference' and 'cooperative identity' in post-socialist and post-conflict context of BiH. Inquiring into the formal and substantive characteristics of this relationship helps establish the quintessence of genuine cooperative enterprise not just in BiH but across the post-Yugoslav geographical space.

Recognizing that cooperatives, as business models of collective action, cannot be meaningfully analyzed in isolation of local and regional political economy, this research will provide a contextual framework of socio-political environment where applicable. In presenting a view of cooperatives that presupposes the need for organizational synergy between economic, social, and advocacy roles of cooperatives in developing countries, this thesis argues in favour of using cooperative model to strengthen social ties and achieve sustainable improvements in well-being of rural population. An argument will be made that in performing their economic purpose cooperatives in transition countries can go far beyond their stated objectives and act as agents of change in terms of actively informing policy making that is, absent this 'cooperative activism', bound to create if not hostile then certainly indifferent environment towards cooperatives.

The advocacy role of cooperatives in context of developing and transition countries may indeed prove to be equally important as economic and social roles of these enterprises. The relationship between public sector and third sector is often not a linear one, even less so in politically unstable and post-conflict societies. Young (2006) argues that the tendency in public policy circles to oversimplify both the motivations to participate in market exchanges and resulting behaviour of third sector organizations may lead to distortions in expectations between what different market actors, government institutions included, can and are willing to offer to actual beneficiaries. Now that governments all around the world opt for various austerity measures in the face of global financial crisis and in doing so contribute to shrinking boundaries of the welfare state, studying their relations with third sector actors appears to be more important than ever before. To Young (2006), whether this relationship is characterized as complementary, supplementary or adversarial is what may ultimately decide the development trajectory of third sector organizations. In a context of an unconsolidated democracy with weak institutions and low levels of institutionalized trust this crucial relationship may be missing altogether. In such situations, central actors from public, private and third sector tend to be polarized and rather than using the institutional system in place, however weak, to communicate needs and expectations they resort to building individual and informal relations securing thus personal gains instead of benefiting the sector as a whole. There is an important void here that can be filled by mobilizing farmers into cooperatives and equipping cooperative associations with skills to help them articulate clearly the interests of farmers to policy makers. Taking collective action in this regard can contribute to decreasing the present information drift between different actors as well as strengthening negotiation power of individual farmers vis-à-vis representatives of other two sectors.

This thesis consists of nine chapters. The organization of the thesis follows the analytical framework described in the first chapter. The research made use of both quantitative and qualitative research methods and included data collection in the field including numerous

interviews with representatives from cooperative sector and government institutions as well as the analysis of secondary sources. Most of the data collection happened during 2011 and 2012. The research findings presented in the thesis come from analyzing the sample of 210 agricultural cooperatives spread throughout the entire territory of BiH.

The first chapter explains the research problem and political economy of the context within which the problem is studied. Apart from outlining main hypotheses and supporting research questions, this chapter tackles the most important information on the Bosnia's much too complicated political and economic system of which administrative and bureaucratic hurdles are just the formal barriers to cooperative development. The objective of this chapter is to usher the study into a wider institutional socio-economic context perceived to be of importance to the overall understanding of the nature of BiH agricultural cooperatives.

The second chapter cuts across the relevant literature and provides a comprehensive review of important concepts, theories and schools of thought that in their own way inform the subject matter of this study. The aim of this chapter, apart from defining the most important concepts, is to introduce the basic theoretical and empirical work on agricultural and rural development, third sector economics and cooperative theory, and basic premises of the NIE that will be used to study the research questions. The literature reviewed represents mainly the studies on different aspects of cooperative sectors in more and less developed countries.

The third chapter is a methodological one. Firstly, it highlights the major methodological approaches to studying cooperatives that are most commonly present in the literature on the subject. Then, it describes the kinds of data obtained for the thesis discussing its limitations and introduces the methodology used for each chapter of the thesis. Apart from outlining the most prevalent approaches to understanding cooperative efficiency and exposing their limitations, this chapter also highlights how, largely as a result of available data, researchers are consciously pushed towards using what on many accounts appear to be inadequate and partial instruments for assessing cooperative performance. This issue is especially pronounced in developing countries where there is little understanding of cooperative nature and how it relates to its performance and where good quality data is not readily available.

The fourth chapter discusses the history of the cooperative idea in the former Yugoslavia highlighting crucial institutional characteristics of the period. Acknowledging the importance of the socialist period in the persistence of some remnants of the informal institutional structure in BiH and its effect on formal institutional environment, this chapter explains the evolution of the cooperative idea in BiH focusing primarily on the period of ex-Yugoslavian agrarian reforms and their effects on the agriculture of BiH in general and agricultural cooperatives in particular.

The fifth chapter looks into laws, bylaws, policies, regulations and various policy instruments that treat and influence matters related to the functioning of agricultural market in

BiH and agricultural cooperatives. The chapter proposes a typology of the most typical policy instruments defined by the institutional structure and used in practice by policy makers to achieve rural development. The fifth chapter is centered on identifying the role various policy instruments have in deterring or stimulating the growth of cooperative sector in BiH.

The sixth chapter presents the results of the empirical analysis of factors affecting cooperative performance in BiH. It starts off by giving descriptive statistics on the state of cooperative sector in BiH to be followed by an OLS model used to analyse the determinants of cooperative performance. Two issues in particular emerge from this analysis. Firstly, a number of cooperatives are characterized by an ill-defined property right structures which negatively affect their performance. And secondly, in more than half of cooperatives studied there is an uneven balance between members and nonmembers associated to the same cooperative. Both of these issues are deemed to be important in explaining the situation in the BiH cooperative sector and are explored in greater detail.

First of the abovementioned issues, namely the property rights structure of cooperatives, is taken up and analysed in the seventh chapter. Additional interviews were conducted in order to identify the channels through which ill-defined property right structures affect the survival and development of cooperatives. This chapter shows how unclear property rights structure affects not only the internal efficiency of cooperatives but also the functioning of supporting markets.

The eighth chapter tackles the matter and likelihood of cooperation among cooperatives in a post-socialist and transitional context through a case study on an attempted second level cooperative in BiH. More specifically, it explores the incentive structure that needs to be in place in order for collaboration among cooperatives to be formalized in a second level cooperative structure. To that end, the chapter assesses the importance of economic incentives, trust, social capital and self-perception of cooperative identity as factors determining the rate of success of innovative cooperative networks.

The ninth chapter is a concluding one. This chapter brings the findings from previous chapters together synthesizing them in an attempt to provide policy recommendations. The objective of this chapter is to stress the relevance of cooperative model to rural development of BiH. The relevance of the model extends beyond providing economic benefits to the members. Indeed, cooperatives are also important in projecting out norms and values associated with democratic governance structures into their communities. This second aspect is especially relevant for unconsolidated democracies and transitional societies which struggle to promote the plurality of organizational forms in their markets.



# Chapter I

## Of Cooperatives, Institutions and Development

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### Setting the Context

*The situation of today shapes the institutions of tomorrow through a selective, coercive process, by acting upon men's habitual view of things, and so altering or fortifying a point of view or a mental attitude handed down from the past.*  
(Thorstein Veblen, 1899)

### Introduction

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In the past two decades, and especially in the aftermath of the latest financial crisis, cooperatives have been hailed as economic organizations that will salvage certain industries given their now well documented organizational capabilities to fend off the effects of the crisis (Birchall, 2013) as well as their ability to mobilize local resources, including physical, financial and social capital, to forge economic and social links among their members and between cooperatives and other market participants. These organizational peculiarities have succinctly been called the “cooperative advantage” and “cooperative difference” and have served to differentiate cooperatives from other firms in the market (Birchall, 2003; Novkovic, 2008).

From its inception in the 19<sup>th</sup> century and through the worldwide political and economic upheavals of the past century, cooperative model has become known for its local embeddedness and its ability to not only correct market failures but to forge important social and communal links among its members.

As a collective action model, cooperatives are especially appealing to agricultural sector in which their capacity to mobilize farmers and their resources into a chain of complementary activities translates directly into lower cost of production and stronger market position for farmers. Because of this agricultural cooperatives are seen as important market participants in many regions and countries across the world. For example, in the European Union (EU) member states where agricultural sector accounts for about 14.7% of the total manufacturing output, cooperatives are responsible for 38.5% of it. Around 40.000 EU's cooperative enterprises along with their 600.000 employees and around 9 million members manage to collect, add value to and place on the market around 60% of the total agricultural produce in the EU (COGECA, 2010). Added to this is now well researched and documented cooperative resilience to various types of

crises owing to their tendency to avoid risky and speculative ventures and investments (Birchall and Katilson, 2009; Birchall 2013).

While the reality documents growing importance of agricultural cooperatives in more and less developed countries alike, theoretical debates regarding efficiency and viability of cooperative enterprises are still present in the literature and continue to stir controversy over the role of cooperative enterprises in development. Stefano Zamagni (2005; 2008) succinctly outlines the basic ideas of confronting approaches to studying cooperative enterprises. On the one hand, there are authors who suggest that cooperatives emerge as a response to market failures but their effect on market dynamics remains marginal owing to their inherent limitations of non-hierarchical structure and non-profit nature (Alchian and Demsetz, 1973; Williamson, 1985). The proponents of this view argue that cooperatives are market occurrences that require the dominant and efficient for-profit enterprise to fail in providing a good or service in order for them to take root. At the same time, the critics do acknowledge the ability of cooperatives to offer something that for-profit firms cannot or do not wish to offer. Still, in their view, cooperatives are exceptions rather than rules.

In a complete contrast to this view is a line of thinking that positions the cooperative model far ahead of the conventional firm, characterizing cooperative enterprise as a model all conventional firms should strive to reach conditioned on their ability to start perceiving 'labour as the opportunity for self-fulfilment and not just as a productive factor' (Zamagni, 2008:2). This view presumes that there is more to human motivation and satisfaction than simply seeking to fulfil pecuniary desires in the working environment and that cooperatives are the precise tool that can aid in generating self-fulfilment through work while at the same time creating both economic and social spill over effects in the community.

In reality and especially in less developed and transitional societies, cooperatives have had mixed results in terms of transforming both the meaning of labor and development trajectory of their respective communities. While the general objective of the thesis is to look into institutional and organizational conditions that have led to cooperative model being underutilized and underexplored in the context of BiH, the specific objective of this chapter is to introduce the main research questions stemming from the specific research context of BiH.

Additionally, this chapter introduces the analytical framework as a guide to how the analysis presented in the rest of thesis is conceptualized. Beyond merely discussing the structural features of cooperative as a unit of analysis, the analytical framework proposed in this research incorporates those factors that are exogenous to the cooperative model itself but significant in understanding the dominant cooperative model in BiH agriculture. By a way of introduction, the chapter outlines the research context, its political and economic characteristics while briefly connecting them to concepts and theories to be invoked throughout the thesis. Finally at its end,

by highlighting purposes and objectives of the research, the chapter spells out the study's main conceptual and policy contributions.

## Cooperatives as a development tool

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Cooperatives can be said to belong to a wide and rich organizational landscape of the non-profit or the third sector organizations. Although their place within the third sector has at times been disputed on account of their handling of economic surpluses and how this behavior fares in relation to the non-profit distribution constraint commonly associated with other third sector organizations, their emergence and role in strengthening the third sector economy can hardly be disentangled from the role and impact of other non-profit organizations (Defourny, Hulgard and Pestoff, 2014). Therefore, cooperatives represent a unique organizational form that fits well within the larger framework of values and principles pursued through the social economy organizations at large. The general divergence among the organizations that populate the third sector can largely be attributed to their different evolutionary paths, complex political, social and economic circumstances that gave rise to the legal frameworks which regulate their functioning and ultimately to the specificities of sectors in which they operate. The undeniable diversity existing among such organizations has inspired scholars to focus more on understanding the reasons that motivate their emergence rather than devising an elegant and succinct definition that describes all third sector organizations (Defourny, Hulgard and Pestoff, 2014). That is why the fundamentals of understanding whether non-profits in general and cooperatives in particular can serve as purposively chosen development tool boil down to one crucial question: why do they emerge?

Hansmann (1987:27-28) offers an artificial but convenient grouping of views on this matter. He groups the existing theories on this matter into two categories of which one concerns the role of nonprofit enterprises and the other category analyzes their behaviour. The former addresses the following questions: why do nonprofits exist and what economic role do they play? Why does their market share vary from one industry to another? The latter category, on the other hand, deals more with motivations of their managers and objectives pursued through this type of organization. The views that can be broadly grouped in this category reflect on questions such as: how does efficiency in nonprofits differ from the one pursued in for-profit firms and can this difference be attributable to the characteristics of each one of these models? Hansmann (1987) further summarizes several theories that take different perspectives in responding to these questions.

The public good theory proposed by Weisbrod (1975) offers a view that nonprofits of all sorts emerge in response to a fraction of unsatisfied demand for public goods. According to this view, the government provides public goods to the degree that satisfies the median voter and

nonprofits represent a collection of private initiatives to provide for those whose needs for a specific public good have not been met.

The contract failure theory proposes that nonprofits emerge to remedy the information asymmetry among stakeholders and consequently to provide interested stakeholders with an opportunity to control both the quality and quantity of certain good or service provided by the nonprofits. Put this way, it is clear that Hansmann conceptualizes the contract failure as an agency issue and non-profit distribution constraint as a way of limiting the ability of managers to exploit the asymmetry of information (Hansmann, 1987). The non-profit distribution constraint as a mechanism for disabling exploitation of managers over other members can be seen as rather appealing.

However, there are also views to the contrary. From the viewpoint of those who study the behaviour of cooperatives, or rather of their managers, it is precisely the assumption of the non-profit distribution constraint that is, in their view, responsible for cooperatives' underperformance compared to alternative governance arrangements. Deriving their argumentation from the orthodox teachings in economics, views have been put forward that qualify nonprofits as enterprises that seek not to maximize profit, but instead they tend to maximize either quality or quantity of certain products, or a combination of both. However, Hansmann (1987) cites Alchian and Demsetz (1972) to argue that regardless of what nonprofits strive to maximize the nondistribution constraint can also be used to explain why nonprofits tend to exhibit greater levels of productive inefficiency compared to their for-profit counterparts. The reason, as Hansmann puts it, is to be found in lack of incentives for managers to minimize costs of the enterprise due to their inability to distribute the net earnings to themselves.

Other views that tackle the behaviour of nonprofits include the supply response theory as well as patron control views. The former argues that the response of nonprofits to a market demand tends to be slower than the response by for-profit firms and this has primarily been explained by the nonprofits' limited access to capital. This, among other factors, also explains their overall numbers compared to for-profit enterprises. The latter view focuses on the ability of patrons, and not just managers, to control decision-making within nonprofits and this has been singled out as the main reason why they emerge in market economies (Ben-Ner, 1986 in Hansmann, 1987).

The scholars of the third sector economics emphasize that to understand the organizations that populate this sector is to understand the principles that are common to them and that serve to differentiate this already internally diverse group of enterprises from the traditional public and private sectors. There are two crucial aspects worth considering in this regard: these enterprises' productive purpose and their internal structure (Defourny, 2001: 6). This is where,

in addition to emphasizing the embeddedness of such enterprises in local socio-economic context, the third sector literature contributes the most towards better understanding of development potential of cooperatives.

A particular aspect of for-profit enterprises that relates both to their emergence and market behavior is self-interested nature of their owners. It is important to understand in what respects third sector organizations in general, and cooperatives in particular, move away from this behavioural assumption in offering benefits to their members and their respective communities. The productive purpose of third sector enterprises as suggested by Defourny (2001) is where one needs to look for clues to understanding the difference between for profit and nonprofit enterprises. The general purpose of third sector enterprises is not self-interested profit seeking behavior. However, this does not mean that such enterprises do not seek to derive economic benefits from their productive activities. While they put no priority on exclusively profit-seeking behavior they instead focus on generating sustainable income or providing other types of benefits for their members. Since third sector enterprises are market participants which generate revenues from their activities, the second aspect where they differ from the mainstream profit oriented enterprises is in the ways in which the generated revenues are redistributed and here one general rule applies: the benefit generated through such enterprises is connected to the frequency of use rather than capital invested or position held within an enterprise. This is especially relevant for cooperatives because they do stand out from other third sector organizations in the way they approach this issue as they often distribute part of their revenues to their members. This is where the non-profit distribution constraint comes in to explain the type of motivation necessary to sustain such an organizational structure. Bacchiaga and Borzaga (2001: 287) refer to social enterprises as “incentive structures that are better able to avert the danger of opportunistic behavior when compared not only with for-profit enterprises and public agencies but also with traditional third-sector organizations such as foundations.” Indeed, this limited profit distribution that characterizes such enterprises prevents self-interested and profit seeking individuals to take advantage of the organizations and appropriate more than their own share of benefits.

Using both these aspects, namely the productive purpose of enterprises and their internal structure, it becomes easier to identify at least three principles common to cooperative enterprises in particular that help see them in the light of their development potential and as part of the third sector family. The three principles are: the user-owner principle, the user-control principle and finally the user-benefits principle (Dunn, 1986: 85). In this sense, a cooperative is defined as “a firm that is collectively owned either by its costumers (a consumer cooperative) or by its suppliers (a producer cooperative)” (Hansmann, 2012:2) and is subject to the collective control by its main users with “benefits derived and distributed on the basis of

use” (Dunn, 1986: 85). Therefore, cooperative patrons, as Hansmann calls them, share two important rights: the right of ownership and the right of control, and are rewarded based on how intensively they use cooperative structures to either consume its services or to supply to or process through it its products (Hansmann, 2012).

Cooperatives are believed to be powerful development mechanisms that, under right conditions, can lift entire groups of people out of poverty and empower them to remain out of it (Birchall, 2003). Their distinctiveness is most commonly visible in their specific ownership and governance structure, but beyond these formal aspects cooperatives are unique in their ability to foster trust and strengthen social ties in a community. As Birchall (2004: 5) writes: “There are many ways of doing business, but there are only a few ways of owning and controlling business organizations.” He further notices that due to prevalence of private and public ownership, we tend to overlook the importance and potential of those organizations that fall in between these two distinct types and therefore miss their development potential.

### Critiques of the cooperative model

Falling into the trap of simplifying the differences between various organizational forms and thus losing sight of substantive variations that exist among them, mainstream approaches in economics tend to criticize the cooperative model on account of its structural features and by analysing it through the lenses applied to other organizational forms. At the outset it is important to acknowledge these critical views and understand the basis of their critique.

Most commonly, critiques focus on cooperatives’ supposed lack of economic efficiency. Two groups of arguments are used to substantiate such a claim. Firstly, arguments based on the structure of cooperatives highlight the tendency of cooperatives to inflate governance, decision-making, and monitoring costs, all of which stem directly from cooperative participative structure. Second group of arguments analyses the behaviour of cooperative members and points to the lack of incentive to invest in long term development of cooperative, a so called horizon problem, and a general presence of the free rider problem.

For instance, Alchian and Demsetz (1972), explaining their theory of the firm, question the ability of cooperatives to perform with levels of economic efficiency comparable to those of profit-oriented firms. In their view, a lack of strong incentive vested in the controller of economic activities in a cooperative resulting directly from its non-hierarchical structure, leads to situations in which all patrons/controllers tend to underperform driving down overall cooperative efficiency levels. In general, internal decision-making processes in cooperatives are seen as limitation to achieving higher levels of economic efficiency (Iliopoulos and Hendrikse, 2009).

A way for cooperatives to correct these inefficiencies, as some argue, is to achieve more similarity with for profit firms. In line with that, Chaddad and Cook (2004) suggest variations to the core cooperative model that range from allowing a non-member investor into the cooperative structure to a complete transformation to a conventional firm. Indeed, it is possible in reality to find evidence of cooperatives transforming into an investor-owned firm at some point during their life cycle. However, this hardly proves anything other than personal preferences of members to switch from one organizational form to another.

### Are cooperatives still relevant to development?

What many of the cooperative model critics fail to recognize is that much of the problems discussed in the previous section are not entirely cooperative-specific and often stem not from the specificities of cooperative features per se but rather from incomplete contracts that underpin almost every market transaction regardless of the governance structure through which it is realized. Although contracts are one of the most important institutions of market economies they are incomplete by nature and can only predict limited number of events and situations. In essence, contracts are a simplification of reality and because of that “the choice of governance structure that can adequately complement contracts and contribute to their implementation becomes crucial” (Menard, 2004: 352).

Adopting a governance structure that fits best the circumstances and nature of transactions is in fact an important guarantee that the innate incompleteness of the contract will not translate into an additional cost. Because of their ownership and governance structure that requires members’ close involvement with cooperative affairs, cooperatives tend to be better aligned with the nature of transaction they set out to organize (Menard, 2004). This makes them better suited than other organizational forms to complement the contracts that regulate their specific transactions and consequently reduce or at least prevent the increase of transaction costs.

Furthermore, cooperatives are important where knowledge of and trust among business partners features significantly into the business processes (Centner, 1988). Studying both general and cooperative-specific social capital Hong and Sporleder (2013) show that presence of social capital in cooperatives is not only essential for their basic functioning but can facilitate and enhance their productivity. For the individual farmers a cooperative itself is a source of social capital. Similarly, in an empirical study Sabatini et al. (2014) show that cooperatives have stronger tendency to foster ties of social capital than other organizational forms present in the market and this in itself testifies to their ability to enhance market exchanges through better contract enforcement and lowering of transaction costs.

Indeed, cooperative governance structure is a complex nexus of relations. However, if members’ interests are sufficiently homogeneous the complexity of governance which, in case of

an agricultural cooperative, brings many independent farmers together does not only serve to compel mutual monitoring for mutual interest but also provides a powerful risk-sharing and bargaining mechanism. In fact, agricultural cooperatives in particular help individual farmers resist market pressures from their up- and downstream partners giving them an opportunity to cut on transaction costs by jointly performing activities related to processing and/or marketing of their produce (Valentinov, 2005; 2007; Tortia et al., 2013).

Hansmann (1980) also highlights the economic role of cooperatives in their ability to fulfil clearly articulated social needs that arise under conditions of market failure and serve as a motivation for choice of non-profit organization over a traditional corporate form. Furthermore, Hansmann also stresses the capacity of cooperatives to economize on market transaction costs for their members while maintaining low ownership costs. To Hansmann cooperatives should not be seen as a side issue in economics. In his view, farmer cooperatives in particular are an interesting organizational form that can primarily benefit farmers through minimizing or entirely displacing the middleman in handling their products while allowing the farmers to reach economies of scale by joining their productive resources (Hansmann, 2000). Among the benefits that Hansmann sees as particularly important for strengthening the market position of individual farmers through cooperatives is the ability of cooperatives to help economize on market information as well as provide a risk-sharing mechanism.

As regards the alleged managerial shirking resulting from the nondistribution constraint associated with cooperative and other nonprofit enterprises, Valentinov (2007) utilizes an argument that relates the structural characteristic of nonprofit enterprises epitomized in the non-profit distribution constraint with the intrinsic motivation of the specific managerial and entrepreneurial type of person who would be drawn to using a nonprofit enterprise in the first place. He then explains that instead of having to deal with less than ideally motivated managers the nonprofits actually attract the type of managers who are intrinsically motivated to mobilize local resources for local benefits rather than amass their personal financial gain.

All of the above discussed features of a cooperative model make it particularly suitable for remedying sector-specific issues pertaining to agriculture and rural development. More specifically, they appear to be especially relevant to societies characterized by a democratic deficit owing to their inclusive governance model and their insisting that every member counts. Naturally, not all cooperatives in practice correspond to the theoretical ideal. In its later parts, this thesis will specifically examine a group of cooperatives in Bosnian context to show in what respects practice of cooperation may diverge from the theory of cooperation and why discussing both organizational and institutional reasons accountable for such a divergence may be helpful in understanding the development potential of the model as such.



The following section will provide an historical insight into cooperative relevance to development by looking at the origin of the movement itself and the types of problems that were addressed through the cooperative model back at the roots of the cooperative movement. The relevance of the following section is in signalling the significance of both context and institutional conditions under which the seeds of cooperation brought about the cooperative movement as we know it today.

## On the origins of the cooperative movement

Reflecting on a number of rather philosophical queries in his 2012 book titled *The Social Conquest of the Earth*, Edward O. Wilson argues that out of all species that have occupied the planet since its creation the most successful were the communities of termites, bees, ants and people – owing to their ability to cooperate for mutual benefit. Indeed, the idea of cooperation is a powerful one not only because it empowers the individual but because it warrants a survival in the face of hardships. The very beginnings of the cooperative movement can be traced back to this essence exactly.

When it was established in 1844 in Rochdale, Lancashire, England, the Rochdale Society of Equitable Pioneers, a group of twenty eight impoverished weavers, set in motion an important international movement and helped articulate its most important values and principles. The main objective of the Society was “to form arrangements for the pecuniary benefit and improvement of the social and domestic condition of its members“(Statutes of the Rochdale Pioneers cited in Fairbairn, 1994:5). The idea was to start an enterprise that would practice the principles of open membership, participative governance and that would distribute benefits in accordance with usage of cooperative.

It is no coincidence that the first successful cooperative was formed at a point in human history that forever changed the relation between capital and labor. Against the backdrop of industrial revolution, high unemployment and poverty, the Rochdale Pioneers came together and expressed what was later to become a gist of principles of cooperation that over the years evolved into internationally recognized standards of cooperative behavior. In the years that preceded the formation of the Rochdale Pioneers, and specifically during 1820s and 1830s, a number of cooperative actions among many socially disadvantaged groups in England went through trial and error stages, all setting a scene for a cooperative movement to finally take root (Birchall, 1997). Among the most notable actions was Robert Owen’s initiative to found an Association of All Classes and All Nations in 1835 that was aimed at uniting all those practicing cooperation in their business endeavours (Zamagni and Zamagni, 2011).

That an international movement was beginning to take shape was evident from a number of cooperative societies that had begun emerging in other countries like the Zurich

Consumverein in 1848, a French society at Hargicourt in 1848, or an Italian society in Turin in 1850 (Birchall, 1997). But it was not until 1895 and much internal debates among representatives of various national cooperative movements that all of these isolated cooperative experiments were gathered under the umbrella of the International Cooperative Alliance (ICA). Far from uniting all cooperative societies, the ICA has over the years provided a pragmatic and useful framework for articulating important views on cooperative identity. By establishing the principles of cooperation at an international level in 1937 and revising them in 1995, the ICA has laid the foundation of cooperative identity that rests on values of self-help, self-responsibility, democracy, equality, equity and solidarity. Above all, through these efforts it has provided the guidance for setting up national legislative frameworks that are flexible enough to accommodate the diversity of enterprises that may engage in cooperative way of doing business.

The history of cooperatives seems to have been the history of localized reactions to the forces of industrialization, urbanisation and rapid growth of market economies (Birchall, 1997). Because of this, the cooperative movement itself has never been solely about strengthening the business dimension of cooperatives but it also amplified the ability of collective action as such to amend inequalities in social structures and to consolidate the social fabric of societies with weak social ties. The profound changes that have shaped the market economy as we know it today have revealed that there are systemic inefficiencies that contribute to reinforcing social inequalities, but also that marginalized groups can minimize the effects of these inefficiencies by pooling their productive resources and thus strengthening their market position (Merrett and Walzer, 2004).

However, the last several years have proven that the movement itself has gathered a widespread institutional support from important international, national and regional actors. Quite remarkably, a 2009 resolution on social economy passed in the European Parliament reiterated the commitment of the EU to support social economy initiatives “whereas the wealth and stability of society derives from its diversity, and whereas the social economy actively contributes to that diversity by improving and reinforcing the European social model and by providing a distinctive business model, which enables the social economy to contribute to stable and sustainable growth” (European Parliament Resolution, 2009).

However, national cooperative movements of EU members and aspiring member countries still carry the marks left by various political and economic uprisings of the 20<sup>th</sup> century. These divergent historical experiences have led to deviations in how cooperative principles have been understood, interpreted and practiced in different regions in the world. The following section will outline some characteristics of cooperation in agricultural sector of BiH that illustrate the diversity of such cooperative experiences.

## Politics and Economics of Cooperation in BiH agriculture

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### On politics and political challenges

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Bosnia and Herzegovina is a deeply divided society. Its divisions are not only territorial and administrative. Its divisions are based on ethnicity, politics and wealth. As such, Bosnian society is characterized by very low levels of generalized trust, and high levels of specific trust but only in family members and close friends. The levels of trust in non-family members and members of other ethnic groups are also low (UNDP, 2009).

Following the end of the most devastating conflict in Europe in its post-World War II history, an internationally brokered Peace Agreement, containing the Constitution of BiH, was signed by the warring parties towards the end of 1995. A peculiar federal-like political structure that was set up for BiH at the time will prove to be one of the most complicated political structures ever attempted by the international community. Its multilayered system of decision-making and power-sharing among different ethnic groups allows decisions to be taken only when there is a strong and consensual political will of relevant political elites representing all three ethnic groups (FPI BH, 2007; Gavrić, Banović and Garreiro, 2013). Such political and systemic circumstances make reforms and effective law-making extremely difficult.

Additionally, the presence of many international actors and their role in decision-making processes in the country has not always yielded expected outcomes (Bieber, 2002). While the Dayton Peace Accord formally ended the war, it also brought about the political structure which primarily safeguards the political inter-ethnic balance at the expense of successful transitioning towards a functional democracy (Caplan, 2000), a feature that will prove especially challenging with the view of BiH aspiring membership to NATO and EU (Aybet and Bieber, 2011).

What McMahon and Western (2009:69) describe as “the most extensive and innovative democratization experiment in history” left BiH with The General Framework Agreement for Peace in BiH<sup>1</sup> that contains eleven annexes covering issues like human rights protection, military affairs, regional stabilization, elections, refugees and displaced person, and perhaps most importantly the Constitution of BiH in its Annex 4. The uniqueness of the Agreement is, among other things, in that it delivers to the people of BiH the internationally brokered constitution to govern their internal affairs. The document was never officially translated to any of the three official languages of the country and was never adopted in its Parliament – such is the detachment of local people from the ultimate law of the country, its constitution.

The Agreement changed the administrative structure of the country and established two entities: Federation of Bosnia and Herzegovina – hereafter FBiH (inhabited mainly by Bosnian Muslims and Bosnian Croats) and Republika Srpska – hereafter RS (predominantly inhabited by

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<sup>1</sup> The official name of the Dayton Peace Agreement. The text of the Agreement is available at [http://www.ohr.int/dpa/default.asp?content\\_id=380](http://www.ohr.int/dpa/default.asp?content_id=380).

Bosnian Serbs). Additionally, the city of Brčko became an internationally supervised district that formally belongs to neither of the two entities and has its own administrative structure. The internal structure of the entities differs considerably with RS being more centralized with clearly delineated functions of entity level government and municipalities while the functions and competences of FBiH are further decentralized and divided between ten cantons and 79 municipalities.

Figure 1 Administrative parts of BiH



Source: Gavrić, Banović and Barreiro (2013), *The political system of Bosnia and Herzegovina: Institutions-Actors-Processes*, Sarajevo Open Centre.

Furthermore, the ten cantons in FBiH, although subordinate to higher levels of governance, have considerable autonomy in policy-making in areas like agriculture, education, culture and social policy and are in reality quite independent from higher levels of governance.

The Constitution of BiH in its Article III on the responsibilities of and relations between the Institutions of BiH (i.e. state level institutions) and the Entities (i.e. FBiH and RS), stipulates areas that are in direct jurisdiction of the state-level institutions<sup>2</sup> and agriculture is not among

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<sup>2</sup> Institutions of BiH shall be responsible for: Foreign policy, Foreign trade policy, Customs policy, Monetary policy as provided in Article VII, Finances of the institutions and for the international obligations of Bosnia and Herzegovina, Immigration, refugee, and asylum policy and regulation, International and inter-Entity criminal law enforcement, including relations with Interpol, Establishment and operation of common and international communications facilities, Regulation of inter-Entity transportation, Air traffic control.

them. In the same article, the Constitution stipulates that whatever is not listed as being explicitly under the state-institutions' jurisdiction is to be considered the jurisdiction of the entities.

In reality, this means that there is no state-level ministry of agriculture, but the sector of agriculture is the jurisdiction of the entity ministries of agriculture, and in FBiH also of relevant institutions at the cantonal level. Since BiH signed the Stabilization and Association Agreement with the EU in 2008 and thus explicitly expressed its willingness to apply for the EU membership, the need arose to have a unified voice towards the EU when it comes to reporting on the sector of agriculture. The coordinating role in agricultural policy making rests with the Ministry of foreign trade and economic relations of BiH.<sup>3</sup> BiH has thus far faced serious problems in adjusting its agricultural sector to the requirements of the accession process precisely due to its inability to formulate a unified policy stance on important agricultural and rural development issues. The country still struggles to compile a unified registry of all agricultural holdings.

The overlapping competences in agriculture resulting from the complex administrative and policy-making structure often lead to mutually cancelling effects of available instruments that should aid structural changes in agricultural sector of BiH. This evident lack of synchronicity is most clearly evident in how direct subsidies for agriculture are allocated or more recently, in the inability of relevant institutions to set up the IPARD structure within the country.

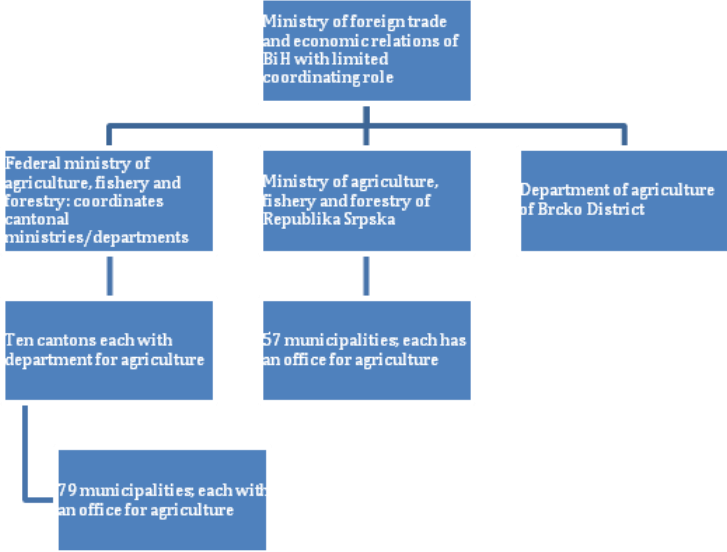
Despite it being an agricultural country, BiH still has no overarching strategy for rural development. Strategic documents are usually enacted at the entity level and thus, often end up being very different both in their aims and policy instruments. Republika Srpska, for example, has recently enacted the Programme for development of agricultural cooperatives for the period 2011-2016<sup>4</sup> while similar document does not exist for the rest of the country let alone for the whole BiH.

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<sup>3</sup> Details on what this jurisdiction entails are available online at the Ministry's website: [http://www.mvteo.gov.ba/o\\_nama/Nadleznosti/default.aspx?id=29&langTag=bs-BA](http://www.mvteo.gov.ba/o_nama/Nadleznosti/default.aspx?id=29&langTag=bs-BA).

<sup>4</sup> Document available at <http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mps/Documents/MPSV%209%2012%2011%20%20-%20PROGRAM%20RAZVOJA%20POLJOP%20ADRUGARSTVA%20U%20RS.pdf>.

Figure 2 A simplified scheme of governance levels in BiH with jurisdiction in agriculture<sup>5</sup>



Source: Own representation using the data from the Statistical office of BiH

Majority of municipalities in BiH, 114 of them, are classified as rural. In the above scheme, all levels of the administrative structure have some role in influencing agricultural sector. In such a highly decentralized context it is difficult to follow policy making process and even more so to understand the effects that each instrument aims to achieve. Inability to precisely identify de facto roles of different actors in BiH agriculture, be they public, private or cooperative has resulted in this sector being generally understudied despite its importance for development of rural areas of BiH.

Agricultural cooperatives in BiH: an overview

The report of the European Commission (2006) on the condition of agricultural market in BiH highlights the significance of the sector in terms of labour force actively involved in agricultural activities estimating that around 18% of population is either informally or formally employed in agricultural sector. The same report estimates that agriculture alone generates around 12% of the country’s GDP.

Agricultural and rural development feature prominently in various government development strategies. However, a lot of goals and objectives in these documents merely pay lip service to development. None of them goes beyond providing general recommendations for development trajectories of the sector, with only a few studies making occasional excursions

<sup>5</sup> In addition to this structure, there are three state level agencies whose work is very much in the agricultural and rural development domain. Namely, these are Agency for food safety, Veterinary Office of BiH, and Directorate for Plant Health Protection of BiH. They have limited relation to cooperative sector, exception being the issues related to exporting the produce and product quality certification. These three offices, however, function under the auspices of the Ministry of foreign trade and economic relations and act as technical assistance in matters related to their specific areas of specialization.

into meaningful discussions on the efficiency of existing policy instruments for agricultural and rural development.<sup>6</sup>

It has been estimated that approximately 81% of BiH territory can be considered rural with around 61% of population residing in rural areas (UNDP, 2013). Majority of BiH rural population engages in some form of agricultural activity either for own consumption or for commercial purposes. Traditionally, as it is visible from Table 1, around 20% of formally employed work in agricultural sector.

Table 1 Key country statistics

	Units	2005	2006	2007	2008	2009	2010	2011
Total area	km <sup>2</sup>	51.197	51.197	51.197	51.197	51.197	51.197	51.197
Population	000	3.844	3.843	3.842	3.843	3.843	3.843	3.840
GDP (at current prices)	mill. EUR	8.655	9.776	11.165	12.659	12.297	12.570	13.025
Value added (at current prices)	mill. EUR	7.120	7.887	8.802	10.275	10.183	10.346	10.730
Economic growth (real change in GDP)	%	3.9	6.8	6.1	5.6	-2.9	0.7	1.3
GDP per capita	EUR	2.252	2.544	2.896	3.288	3.200	3.271	3.392
GDP per capita in PPS	EUR	:	6.400	7.200	7.600	7.400	7.500	:
Inflation	%	3.7	6.1	1.5	7.4	-0.4	2.1	3.7
Total employment	000	:	811	850	890	859	843	816
Unemployment rate	%	:	31.1	29.0	23.4	24.1	27.2	27.6
Total export of goods	mill. EUR	1.934	2.640	3.035	3.432	2.828	3.628	4.204
Total import of goods	mill. EUR	5.717	5.823	7.106	8.330	6.317	6.962	7.938
External trade balance	mill. EUR	-3.783	-3.183	-4.071	-4.899	-3.489	-3.334	-3.734
Share of food, beverages and tobacco in total household's expenditures	%	39.6	39.4	39.1	:	:	:	35.0
Exchange rate (1 EUR =)	KM	1.956	1.956	1.956	1.956	1.956	1.956	1.956

Sources: Agency for statistics of BiH; Central Bank of BiH.

The capacities for agricultural and rural development in BiH are naturally to an extent a function of its geographical location, available arable land, and technological factors associated with possible advancement in agricultural production. This, however, is just one side of the coin. The other side is represented by the institutional and organizational structures that ought to allow for an optimum efficiency level to be reached under given climatic and geographical conditions. The institutional structure itself should lay grounds for conditions in which individuals will be able to choose from many existing market coordination mechanisms in an attempt to satisfy their intrinsic and/or extrinsic motivations.

According to the 1991 census<sup>7</sup>, around 48% of BiH population reported to own some amount of agricultural land (Bogućanin et al., 2011). As is reported in Table 2, out of the available arable land, close to 50% is left idle with minor variations in land usage from 2005 to 2011. Small and inefficient farms represent one of the major challenges to BiH agriculture. According to the USAID survey of agricultural holdings in BiH (2011), average farm size in BiH ranges anywhere from 2 to 3 hectares.<sup>8</sup> It is very difficult to come by any kind of reliable data on farm structure

<sup>6</sup> Some of the strategic documents include: Medium Term Development Strategy BiH (2004-2007) and its revised version, Medium Term Agriculture Sector Strategies for both the Federation of BiH and the Republika Srpska from 1999; Development Programme for Agricultural Cooperatives in Republika Srpska 2011-2016.

<sup>7</sup> The 1991 census was the last census for which we have the official results. The next and the latest census was carried out in October 2013 but no official data were released to date.

<sup>8</sup> There are various estimates of the farm sizes in BiH. Ministry of foreign trade and economic relations of BiH, as a state level ministry, has the mandate to overlook the evolution of the Registry of agricultural holdings in BiH and it has proposed similar estimates on the average farm sizes in BiH. But it can be seen from Table 2 containing key agricultural statistics that there is no official data on farm structures and sizes.

due to highly decentralized administrative structure of the country, even when it comes to collecting statistics on such important issues as farm structure.

Table 2 Key agricultural statistics

	Units	2005	2006	2007	2008	2009	2010	2011
<b>Gross value added of the agriculture, forestry, hunting and fishery sector (A)</b>								
- GVA (at current prices)	mill. EUR	751.0	825.3	885.0	942.1	899.6	887.1	900.7
- share in GVA of all activities	%	10.5	10.5	10.1	9.2	8.8	8.6	8.4
<b>Employment in the agriculture, forestry, hunting and fishery sector (A)</b>								
- number	000	:	167	168	183	182	166	160
- share in total employment	%	:	20.6	19.8	20.6	21.2	19.7	19.6
<b>Trade in food and agricultural products</b>								
- export of agri-food products	mill. EUR	117.9	138.2	171.9	217.1	238.3	288.3	317.7
- share in export of all products	%	6.1	5.2	5.7	6.3	8.4	7.9	7.6
- import of agri-food products	mill. EUR	1.006.2	983.7	1.130.5	1.319.8	1.209.9	1.261.5	1.404.0
- share in import of all products	%	17.6	16.9	15.9	15.8	19.2	18.1	17.7
- trade balance in agri-food products	mill. EUR	-888.3	-845.5	-958.6	-1.102.7	-971.6	-973.2	-1.086.3
<b>Agricultural land, total</b>								
- Arable land	000 ha	2.164	2.165	2.155	2.146	2.153	2.150	2.161
<i>of which fallow and uncultivated land</i>	000 ha	472	470	466	451	472	492	478
- Land under permanent crops	000 ha	100	101	100	104	105	108	107
<i>of which orchards</i>	000 ha	92	93	92	95	97	99	97
vineyards	000 ha	5	5	5	6	6	6	6
olive trees	000 ha	0	0	0	0	0	0	0
other permanent crops (nurseries)	000 ha	3	3	3	3	2	3	4
- Permanent grassland	000 ha	1.036	1.035	1.030	1.032	1.049	1.035	1.045
<i>of which meadows</i>	000 ha	451	451	439	442	438	439	440
pastures	000 ha	585	584	591	590	611	596	605
- Other agricultural land	000 ha							
<b>Farm structure</b>								
Number of agricultural holdings	000	:	:	:	:	:	:	:
Utilised agricultural area (UAA)	000 ha	:	:	:	:	:	:	:
UAA per holding	ha	:	:	:	:	:	:	:
<b>Change in volume of Gross Agricultural Output (GAO)</b>								
- Total	%	:	7.8	-3.0	29.1	-5.0	-0.9	:
- Crops	%	:	4.2	-3.4	31.0	-5.6	0.9	:
- Livestock	%	:	14.1	-2.5	26.0	-4.0	-3.9	:
<b>Share of crop and livestock output in total Agricultural Goods Output</b>								
- Crops	%	63.9	61.8	61.6	62.5	62.1	63.2	:
- Livestock	%	36.1	38.2	38.4	37.5	37.9	36.8	:

Sources: Agency for statistics of BiH; Central Bank of BiH; Chamber of Commerce of BiH

National Agency of Statistics of BiH holds no data on agricultural cooperatives or on their overall economic contribution to agricultural sector. According to the data obtained from the Cooperative Association BiH<sup>9</sup>, approximately five hundred agricultural cooperatives are currently registered in BiH. This estimate is based on the court registry records but it does not reflect the numbers of fully active and functioning cooperatives. The exact number of active cooperatives is unknown to the Cooperative Association BiH.<sup>10</sup> The only reliable, yet limited, source of data on active cooperatives in BiH can be obtained from the Agencies for Financial,

<sup>9</sup> Ms. Vesna Kolar, an employee of the Cooperative Association of BiH, suggested that this data was never fully updated because many cooperatives failed to re-register at local courts after the General Law on cooperatives was adopted in BiH in 2003. Many cooperatives failed to get legal assistance necessary to register anew, i.e. to renew their legal status in accordance with the new law. Interview conducted in July 2010.

<sup>10</sup> The General Law on Cooperatives does not create a legal obligation for cooperatives to be members of any of the existing three apex organizations. This leads to a situation in which information on cooperatives is either dispersed among the three apex organizations or simply not collected in the case of cooperatives that do not belong to either one of the three associations of cooperatives in BiH. Consequently, there are no numbers of cooperatives in BiH, let alone their characteristics and the magnitude of their market activity. All cooperatives are left with the choice to voluntarily register with entity-level ministries of agriculture if they wish to be considered for government subsidies, a provision that applies to all agricultural actors including cooperatives and is therefore not cooperative specific. The process of registration does not entail the obligation for cooperatives to supply the ministries with the detailed information on their business conduct and/or their internal structures and eventual management changes that they undergo.



Information and Mediation Services (AFIP/APIF) but this data is purely financial in nature and completely silent regarding organizational features of agricultural cooperatives.<sup>11</sup>

Based on the data obtained from various sources, it can be claimed with some confidence that in the period from 2006 until 2013 the numbers of active cooperatives in BiH ranged anywhere between 160 and 230.<sup>12</sup> Compared with the turnover of the entire agricultural sector, the turnover of a relatively small number of agricultural cooperatives makes them only a minor actor in BiH agricultural market. However, given the structure of BiH agricultural sector and overall numbers of BiH citizens whose livelihoods depend on agriculture, this model, with all its advantages, appears to be a form of business organization that could prove useful in overcoming some of the acute difficulties small farmers face in increasingly liberalized domestic market.<sup>13</sup>

Geographically, BiH belongs to a group of relatively small countries but its climate and terrain make it very conducive to a variety of agricultural activities (World Bank, 2010). Given the natural inclination towards agricultural activities and a considerable percentage of rural population already engaged in agriculture, it begs a question how it is possible that such a market in agriculture populated by small, inefficient and often non-contiguous farm holdings did not motivate farmers to form more cooperatives or improve the existing ones? Are farmers' needs well-served by the existing cooperatives? If so, what then contributes to cooperatives having such a bad reputation in public policy making circles?<sup>14</sup> Are the reasons for this perception to be sought in the prevalent cooperative model itself, in the structure of cooperative movement in BiH, or in the interaction of these two with wider institutional environment? What institutions that have been proven to be critical to cooperative development elsewhere are currently missing in BiH? These are only some of the research questions that will be studied using the framework of analysis presented in the following section.

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<sup>11</sup> Agency for financial, information and mediation services of Federation of Bosnia and Herzegovina (AFIP) and Agency for mediation, information and financial services of Republika Srpska (APIF) are entity-level institutions established by the decisions of entity governments and tasked with gathering financial data from legal subjects active in the market of BiH.

<sup>12</sup> Cooperatives that have had any kind of turnover are required by law to submit a financial report to AFIP/APIF at the end of each financial year. These cooperatives are generally considered as active cooperatives and will be treated as such for the purposes of this research.

<sup>13</sup> Ms. Jelena Prorok, Ministry of foreign trade and economic relations of BiH, Department for Rural development and agriculture Interview conducted in July 2013.

<sup>14</sup> Various interviews conducted with many civil servants working in the field of agriculture, including some cooperative members have convinced the researcher that there is a great deal of misunderstanding of the role of cooperatives in a recently introduced open market economy in BiH. Existing cooperatives are being stigmatized and tacitly left out of any government support schemes. The support they receive is rather incidental and this, according to the views of policy makers, is partly to be considered the responsibility of cooperatives themselves who seem to be too reliant on state support for functioning.

## Framework of analysis: Concepts, Ideas and Theoretical Assumptions

This section will highlight some of the basic concepts, ideas and theoretical assumptions that derive from the literature and are helpful both in understanding the importance of the research problem presented in this thesis and framework of analysis applied to studying it.

## Sectoral specificities: urban and rural market failures

Agriculture is a sector in which productive activities tend to be affected not only by controllable forces but also by a host of factors that are beyond one's control. An array of risks associated with economic activities in agriculture is thus not easy to avoid or mitigate except through a number of strategies that venture into the area of organizational innovativeness aimed primarily at risk reduction (Kast and Rosenzweig, 1979).

Agriculture is one of the sectors where the need to move away from supply to demand driven production is further accentuated by both rather sophisticated demand for products of high quality and still high poverty levels in rural areas. The role of state institutions in making the shift from supply to demand driven production in agriculture possible, especially in countries with underdeveloped market institutions, thus becomes crucial to ensuring the competitiveness of small agricultural producers. In fact, recent analysis of agricultural sectors in a number of countries reignites the debate over the role of public policy instruments in agricultural development and casts doubt over the usefulness of the so called new conventional wisdom policies of market liberation and state non-involvement in shaping agricultural development. As a matter of fact, it has been recognized that state intervention and carefully tailored public policy is not only necessary but it needs to have a sense of continuity for agricultural sector to flourish (Chang, 2009). Contrary to the new conventional wisdom approach, agricultural sector needs government intervention in the form of favorable policies and instruments that can mitigate some of its sectoral limitations.

Furthermore, Valentinov and Baum (2008) argue that market failures in rural settings are often of different magnitude and depth than those in urban areas and as such may not be fixed by the usual neoclassical suggestions of for-profit firm strategies. Rural areas are often times characterized by much higher transaction costs than is the case with urban areas mainly due to lack of well developed infrastructure and extension services. Therefore, they argue, rural market failures require alternative institutions to mitigate such failures, ones often involving collective action in form of self-help groups, associations and cooperatives. And for these solutions to function, the state needs to provide the minimum of institutional stability and functionality.

Along the same lines, Dorward et al. (2005) maintain that weak institutional settings in least developed countries characterized by higher risks associated with doing business, higher information and transaction costs, poor or altogether missing basic infrastructure are some of

the features of their markets. Investor-owned firms (IOFs) seem to be a bad fit for such fragile institutional settings, especially in terms of their ability to fix market failures. Under such conditions, some form of collectively organized action may facilitate the decrease in information and transaction costs, help provide basic infrastructure through cost and risk sharing, and ensure enforcement of clearly defined property rights. In other words, failures in rural markets with high poverty levels need to be mitigated by a collectively organized response by means of a non-profit actor (Valentinov and Baum, 2008).

### From institutions to development or from development to institutions?

Among the central themes in this thesis is the analysis of institutions, both as 'institutional environment' and 'institutional arrangements' (Williamson, 2000). Even though there has been a considerable divergence of approaches to defining institutions both in conceptual and practical terms, there appears to be an evident agreement of recent literature over the role played by institutions not only in causing but also in sustaining economic development in the long run (Eggertsson, 1990; Alesina and Perotti, 1994; North, 1987, 1990; Easterly and Levine, 1997; Williamsson, 2000; Acemoglu et al., 2001; Nelson and Sampat, 2001; Fabro and Aixala, 2009).

The scholarly divergence in opinion regarding the meaning, scope and economic impact of various institutions and institutional arrangements of formal and informal nature seems to have arisen out of different perceptions on the limitations of human economic reasoning and consequential behavioral patterns of economic actors in various governance structures.

The mainstream economics rests on several rather rigid assumptions regarding perfect information availability which when coupled with assumptions of perfectly rational and narrowly self-interested homo economicus lead to a view of the world that, though theoretically satisfying, is far from reality. In reality, explaining complex matters like economic development tends to involve unacceptably large margin of error mainly because information is not readily available and contracts created among less than perfectly rational actors are inherently incomplete. In an interest of reducing this margin, institutional economics, both old and new, have introduced the study of formal and informal institutions into the grand equation of economic development. It has been repeatedly proven that over time institutions leave a significant mark on economic performance of entire systems but also of its components (Nabli and Nugent 1989).

In addition to recognizing the role of institutions in fostering economic development, through his seminal 1937 article on the nature of the firm, Coase emphasized the need to not take 'firm' as a given entity. In other words, Coase proposed that firm, just like market, be treated as a transaction cost economizing instrument – this insight had all the groundbreaking

features and served the purpose of expanding the boundaries of economics, in both micro and macro direction. In more specific terms, by qualifying firm as just one of several ways through which transaction costs can be minimized, Coase ushered economics into the discussion about properties of other governance structures and their cost minimizing capacities. That way not only did governance arrangements become important but also the institutional environment surrounding them.

North's (1994:360) view of institutions is noteworthy: "Institutions are the humanly devised constraints that structure human interaction. Together they define the incentive structure of societies and specifically economies." Aware that very often the term 'institution' can colloquially be stretched to mean organizations as well, North goes on to clarify that:

*Organizations are made up of groups of individuals bound together by some common purpose to achieve certain objectives. Organizations include political bodies (e.g., political parties, the Senate, a city council, regulatory bodies), economic bodies (e.g., firms, trade unions, family farms, cooperatives) social bodies (e.g., churches, clubs, athletic associations), and educational bodies (e.g., schools, universities, vocational training centers) (1994:361).*

Stemming from North's view, cooperatives qualify as organizations, while the laws, regimes and regulations in the realm of political economy qualify as their immediate institutional environment. Their overall characteristics and mutual interaction are both instrumental to explaining the levels of development in a society.

### Acknowledging the embeddedness of cooperative enterprises: the social economy insights

Neither neoclassical economics nor NIE insights are able to fully capture and explain the role of the organizations whose motivation for participating in the market differs from the standard rational and selfish one. One other feature of the third sector organizations that goes unrecognized by both these traditions is their embeddedness in wider social, economic, political and even cultural context. To compensate for the existing limitations the social economy tradition provides quite a number of insights into the motivations for setting up organizations whose business philosophy does not confine itself to the profit-seeking utility of standard firms. Therefore, a proper understanding of the motivations behind the existence and market participation of such enterprises rests on the need to supplement the standard institutional explanations with the views from the social economy tradition.

An important distinction between the social economy and nonprofit sector must be made at the outset. While the idea that there is a group of enterprises that by their purpose and features defy the monopoly of public-private dichotomy in the market begun to emerge in the 1970s, the way in which such enterprises were understood and studied in different parts of the world took different trajectories. The scholarly tradition of the United States' universities

through its intensive research programmes on nonprofit organizations in the late 1970s started using the term 'non-profit sector' to denote this newly emerging group of enterprises. The kinds of enterprises that fall into this category are those that are regulated by tax-laws in the USA, i.e. they are exempt from paying income taxes and none of their earnings should be allocated to their managers and members. In this sense, the non-distribution constraint on the earnings is understood quite literally. By that token, cooperatives are excluded from the nonprofit sector since they do distribute part of their annual surplus to their members. On the other hand, the tradition that first emerged in France and later spread across other European countries uses the term 'social economy' or 'the third sector' to denote the enterprises whose productive purpose does not boil down to profit seeking behavior of managers. Instead, in this tradition, all enterprises that function to serve their members, fulfil some social aim, employ democratic procedures of decision-making even if they redistribute some of their earnings to their members can be considered a part of the social economy (Defourny, 2001).

The European view of the third sector is wider than the American one and it clearly leaves enough space for cooperatives to blend in. The non-distribution constraint is still valid feature of such enterprises but it is not as restrictive as it is in the non-profit sector tradition. Instead, it is taken to mean that pursuing economic activities through social economy organizations may generate revenues and these revenues can partially be distributed to these organizations' members as part of the general benefits provided to them. However, non-distribution constraint is not absolute but it is subject to limitations and generating profit is not a primary purpose but it emerges as a result of economic activities (Defourny, 2001). The focus here is on the notion of association and associative behavior of individuals through such organizations (Defourny and Develtere, 1999).

The normative approach to studying the third sector organizations, involves a study of "their production objectives and internal organizational methods" (Defourny and Develtere, 1999:16; Defourny, 2001; Defourny, 2014). These two aspects allow scholars of the social economy to define the sector as a whole using some of the features common to all organizations:

The social economy includes all economic activities conducted by enterprises, primarily cooperatives, associations, and mutual benefit societies whose ethics convey the following principles:

1. Placing service to its members or to the community ahead of profit,
2. An independent management,
3. A democratic decision-making process,
4. The primacy of people and labour over capital in the distribution of income.

(Defourny, 2001: 6)

The main divergence between the non-profit and social economy approaches is on specification of the goals, control of the organization and distribution of earnings (Defourny, 2001: 6-7). However, one thing remains in common: this distinct category of enterprises is shaped by local needs and circumstances and evolves in response to them. This embeddedness in the local context is what brings out the social and development aspect in them to the fore and what indeed makes them different from either public or private enterprises. This aspect in particular is not fully accounted for in either neoclassical or institutional perspectives.

As a result of being fully focused on the needs of their members and embedded in their local context, cooperatives can also be viewed as specialized advocacy groups for farmers in their relations with public policy making bodies. This role may be particularly important in less developed countries and has seldomly been studied in the literature. While cooperatives in transition economies are necessary for reasons of economic nature, they are also instrumental as vehicles of farmers' interests with the potential to shape local rural political economy, to say the least. This role can be used either to benefit more from government offered programmes (not necessarily subsidies only), to have better information on sector specific news, to become more informed of potential donor grants – all important and legitimate sources of external know-how and much needed financial capital. Extending the purpose of a cooperative beyond the economic one provides powerful insights into the processes through which cooperative can contribute to a meaningful rural development.

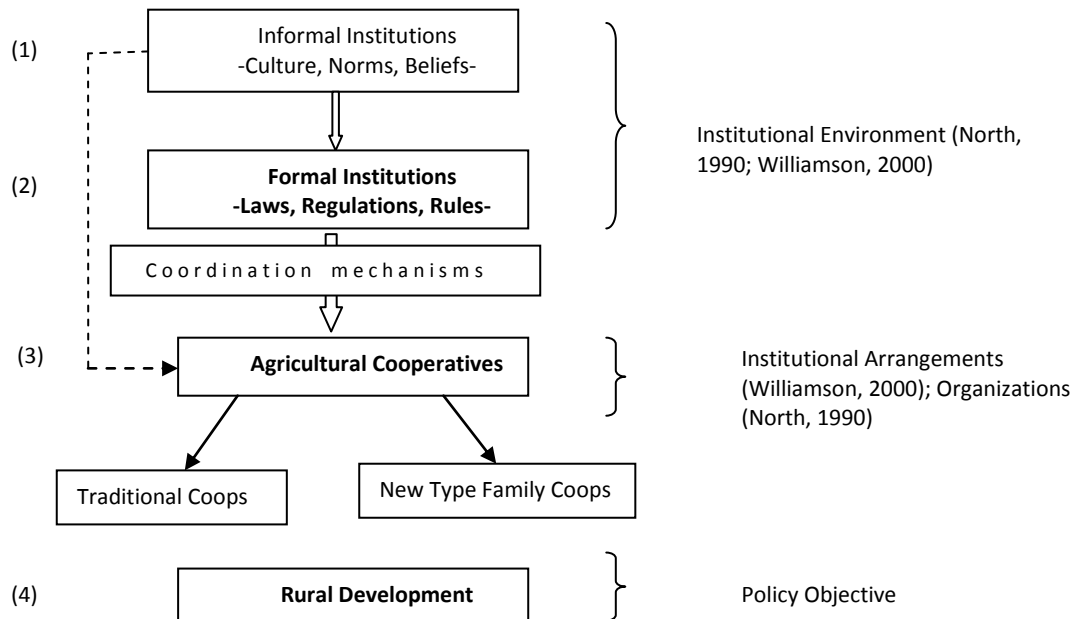
For a better understanding of why this is important it is helpful to place a cooperative in a wider socio-political context, to zoom out from the cooperative as a governance structure so that political economy of the context may be better appreciated as a variable that affects the ability of cooperative to fulfil its purpose. If a cooperative is an enterprise of dual nature, namely economic and social (Bonus, 1986), fulfilling the economic needs of its members amounts only to a partial accomplishment of cooperative objectives. Moreover, the social needs that can be fulfilled through a cooperative are only partly gratified within the organization itself and have not been precisely defined in the literature with their boundaries and reach still left unclear. Engaging with other social structures may prove valuable in spreading the values of cooperation especially in a context where such values are generally lacking among its members and additionally, to understanding what truly constitutes the social aspect of a cooperative enterprise. These aspects will be tackled in greater detail in Chapter II.

## Analytical framework

The previous section highlighted the essential assumptions that are relevant to the research problem studied in this thesis. The analytical framework for this research is inspired by and draws heavily from Williamson's (2000) contribution to understanding different levels at which institutions can be analyzed, including their mutual interaction. In a broader sense, it corresponds to Williamson's classification of institutions into 'institutional environment' and 'institutional arrangements'.

The following analytical framework presents a number of building blocks through which the concepts discussed in the previous section will be engaged when tackling this thesis's main research questions. Each of the levels of analysis is discussed in a separate chapter in the remainder of the thesis.

Figure 3 Analytical framework of the research



The scheme in Figure 3 explores the dynamic relationship that exists between informal institutional environment (past regime's values), formal institutional environment relevant for agriculture and cooperatives (2), internal characteristics of agricultural cooperatives (3) within that environment and the concept of rural development (4) as defined in legislative framework for agricultural and cooperative sectors. Chapters four through nine explore these four levels of analysis.

Three essential concept blocks and their mutual dynamics form the backbone of this research, namely presently existing formal institutions, agricultural cooperatives and rural development. Recognizing that informal institutional environment is a challenging research

subject and well beyond the scope and focus of the this research, its impact on formal institutional environment in the case of BiH will not be measured as such but it will be assumed based on the experiences of other post-socialist countries, as documented in many qualitative and quantitative research papers that treat the issue. In other words, the analysis that will explain the channels through which the past values encroach upon the meaning and functioning of cooperatives today will rely on secondary data sources. Several research questions help understand these influences such as: what was the relationship between state structures and cooperatives in the socialist BiH; how was that relationship operationalized through laws and policies; what was the likely effect of their relationship on present institutional structures and relations between public institutions and cooperatives?

Level two (2) of the analytical framework refers to formal institutional environment and it is for the purposes of this research taken to comprise the collection of laws, bylaws, regulations and rules that set the framework for the market as a whole and define the behaviour and status of actors in agricultural market and that, as a final goal of its implementation, seek to foster better quality of rural life, i.e. rural development. For the purposes of this research, the role of formal institutional environment will be appraised based on its ability to:

- (a) Remove the obstacles to proper functioning of the market in agriculture, with specific reference to cooperative sector; i.e. basic role.
- (b) Facilitate and improve market functionality in agricultural and cooperative sectors through creation of specific policy instruments and measures; i.e. forward looking role.

In other words, the main research questions asked in the chapter that deals with this level of analysis are: how are cooperatives treated by current law in BiH; does this treatment enables or stifles their development; what kind of role of public institutions is likely to be most conducive to creating a cooperative friendly environment and instigating rural development?

The analytical framework above does not illustrate the direct linkage between formal institutional environment and rural development although it recognizes that development of rural areas should be the final goal of laws and policies regulating the agricultural sector. The absence of the link serves to show that the policy treatment of cooperative model in BiH legislation and the prevailing model of cooperation in BiH agriculture do not reveal a clear link through which present policies aim to achieve any level of rural development using the model as such, in either its traditional or more recent form. Since agricultural cooperatives have a historical significance for the agricultural sector of BiH and are generally considered to be one of the oldest forms of farmers' organizations in this region, it is important to clarify the extent to which the present laws, regulations, and policy instruments stifle or foster development of agricultural cooperatives. The implementation of laws and policies that have been enacted so far



does not reach the level necessary for rural development in BiH to be described anything other than sporadic and accidental. In any case, there is no evident systemic approach towards using all resources possible to trigger and sustain development of rural areas in BiH and to redefine their relationship with urban areas. It has been evident for a while that among the main contributors to such a situation is the complex administrative structure of jurisdictions in agriculture. The relationship that goes in opposite direction, i.e. from development to institutions, must not be disregarded either. Badly conceived and missing institutions may as well be the product of chronic underdevelopment of rural areas in BiH.

Furthremore, it is important to note at the outset that this research concieves of cooperatives as one among many possible mechanisms for coordination of economic activities, which is clearly visible in the Figure 3 itself. The role of coordination mechanism in this sense is to be a flexible transaction cost reducing tool.

This thesis will show that the strength of the cooperative model and its development potential derive not only from its ability to economize on market transaction costs but also from its potential to create stability in business and community relations through fostering creation of social capital. Consequently, the very difference of the cooperative model that sets it apart from other market coordination mechanisms may in fact be the source of its strenght and longevity.

For the sake of brevity in the analytical framework there appear to be two general (generalized) types of cooperatives, namely traditional and various other deviations from the traditional form that are named 'new type family coops'. In reality, there are many more variations under each of these two categories and these will be explored in some details in the reminder of the thesis. The dashed line connecting the informal institutional structure and agricultural cooperatives in Figure 3 signifies an indirect relationship between the two, while the subject matter of the present research will be the relationship between levels (2), (3) and (4) in the analytical framework.

Some of the research questions that will be explored through the above explained analytical framework are as follows: What models and types of cooperatives exist in BiH agriculture and what are their basic organizational characteristics? What kind of policy instruments are currently being applied with the purpose of aiding development of cooperative sector, if any? What institutional and organizational factors affect cooperative performance? Detailed hypothesis, as well as supporting research questions will be presented in Chapter III and discussed in separate chapters.

## Conclusion

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The aim of this chapter was to provide a basic outline of the context within which the topic of this thesis will be studied. In doing that, it provided an introduction into the idea of cooperation by outlining the major theories that explain the emergence of cooperatives in market economies and their place within the third sector and nonprofits literature. Additionally, it presented a brief overview of circumstances surrounding the emergence of the first formal cooperatives and their gathering under the umbrella of an international movement. Following from this broader introduction, the chapter presented both political and economic context in which cooperatives function in BiH. As it was explained earlier, Bosnia is still a much divided society with complex governance structures susceptible to various political pressures and with very low levels of trust among its citizens. All of these divisions are reflected in the functioning of its cooperative sector. Consequently, the formal cooperative structures in BiH that should aim to unite farmers often serve not to bridge the societal divides among them but to consolidate them, albeit indirectly or unwillingly.

This Chapter emphasized that while the contributions from the institutionalist school, both old and new, are valuable in their insistence on the role of institutions in understanding and explaining the behavior of various governance arrangements these contributions alone do not suffice to explain the particulars of the third sector organizations' nature. The third sector and nonprofits literature is thus consulted to bridge the gaps that are apparent in neoclassical literature and institutionalist approaches in an attempt to emphasize that third sector organizations, and especially cooperatives, differ from for profit firms on two important counts: the purpose they seek to fulfil and the internal organizational structures through which this purpose is being realized. The chapters that follow will first detail the interplay of various literatures in explaining the development relevance of cooperatives to be followed by chapters that position this particular governance structure within a wider cooperative experience of Bosnia's cooperatives.

# Chapter II

## Literature review

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*People who are rich find it hard to understand the behaviour of poor people.  
Economists are no exception, for they too find it difficult to comprehend  
the preferences and scarcity constraints that determine  
the choices that poor people make.  
(Theodore W. Schultz, 1979)*

### Introduction

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There is a substantial body of literature dealing with both advantages and limitations of collective action in agriculture. Given the depth of knowledge on the subject, the objective of this Chapter is to present a selective yet thorough literature review of main scholarly contributions in the fields of development economics, new institutional economics: its transaction costs and property rights approaches in particular, as well as third sector economics – all of which are explicitly or implicitly related to the main research questions of the thesis. There are three broad sets of the literature presented in this chapter: a) On the sector specific characteristics; b) On actors and transactions: views from the institutionalist perspective; c) Views from the third sector literature to glue together the relevant parts from the previous two strands of literature.

Thus organized this literature review has a twofold aim. Firstly, it testifies to the multidisciplinary nature of the present research by covering a wide enough range of relevant topics crucial to understanding the possibilities and limits of agricultural cooperation in a developing country context. Secondly, by juxtaposing the most relevant concepts and theoretical premises from the abovementioned fields, the chapter seeks to identify the gaps and missing links in the literature regarding the treatment of cooperative model's potential to deliver rural development in a developing and transitional society. The identified gaps serve to guide the rest of the study.

In presenting the literature the chapter takes a funnel-approach. It starts off by discussing the relevant conceptual and policy differences between agricultural and rural development highlighting how the specifics of the sector necessitate the existence of the cooperative model. From this general debate in the field of development economics it then moves on to discussing insights from both old and new institutional economics and ends on a

more specific note reviewing scholarly contributions that focus directly on theory and economics of third sector organizations in general and agricultural cooperatives in particular.

## Agricultural and Rural Development: Conceptual Issues

### The special status of agriculture in development

Developing agriculture and improving the livelihood of rural dwellers appears to be a strategic goal of governments across the ideological spectrum. Agriculture and food sectors are often seen as somewhat 'special' (Cook et al., 2008). There are several reasons why agriculture matters to every country regardless of its political system and level of development. Firstly, it has been estimated that close to 75% of poor people in underdeveloped countries live in rural areas and depend mainly on agricultural activities for their living (Byerlee et al., 2009; IFAD, 2011). Secondly, agricultural production cycle is fixed to a host of natural phenomena and is mainly seasonal in nature. Coupled with high asset specificity this makes agriculture highly uncertain as a sector (Cook et al., 2008) and as such calls for various kinds of interventions aiming at reducing the uncertainty levels. Thirdly, in most of developing countries agricultural industry is really the only industry that makes serious contribution to national income while at the same time being a direct provider of food stuff for the poorest (Johnston and Mellor, 1961). It is this strategic role of creating food security that puts and sustains agriculture on development agendas.

Effectively, the fact that agriculture is a risk-abundant sector makes its institutional environment a rather relevant factor in envisaging the development trajectory of the sector. In that regard, it is necessary to note that the agriculture specific risk factor stems not only from the nature of the sector itself but from peculiar political and economic environment in which the sector operates. Arguably, agriculture is the only sector where risk taking is not related to potential gains in the same way as it is in other sectors. Therefore, the very estimate of risk in agriculture depends not only on evaluation of one's propensity towards risk taking but also on taking into account the factors that are by nature beyond one's estimation. This has a direct bearing on a number of risk-mitigating mechanisms developed in agriculture specifically forming a spectrum of vertical contractual relations that ran from very informal associational groups to highly formalized cooperative structures (Cook et al., 2008). Some authors argue that this dependence of the sector on natural factors highlights the need to invest more in improving the predictability of other important performance determinants in agriculture. In line with that, it is suggested that investments in development of human capital - skills and knowledge in particular - fostering of entrepreneurial ability of farmers and initiating organizational innovativeness of production processes tend to have the highest return in the long run (Schultz, 1961

## From agricultural to rural development

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Although agricultural development has traditionally been considered central to economic development of more and less developed countries alike, the policy responses to development agendas across the board differ mainly on the account of what is seen to constitute the 'agricultural development' in different development contexts, both time and region wise. While in more economically advanced countries it has been seen as a somewhat passive stage towards intensive industrial growth with the main purpose of providing its surplus labour to industry and supplying cheap food to urban areas and as such was often subsidized, in less economically advanced societies agricultural activities have constituted merely means of survival for the poorest members of society. In his Nobel Prize lecture in December 1979 Theodore W. Schultz summed up nicely the importance of link between the economic knowledge of poverty and economic knowledge of agriculture:

*Most of the people in the world are poor, so if we knew the economics of being poor, we would know much of the economics that really matters. Most of the world's poor people earn their living from agriculture, so if we knew the economics of agriculture, we would know much of the economics of being poor.*<sup>15</sup>

In a developing country context, we tend to think of agricultural development as being part of the poverty reduction strategy. And rightly so. However, despite attempts to use agriculture to improve the livelihoods of rural poor the striking levels of poverty still persist in rural areas around the globe (Diao et al., 2007). At the same time, empirical research has confirmed that no meaningful development in other sectors can happen without agricultural growth (Lipton, 2005). It has also been confirmed that, besides providing the basis for development of other sectors, agriculture itself contains various growth linkages that, if properly utilized, can bring about greater level of technological advancement in the sector and greater quality of the produce (Johnson and Mellor, 1961; Hirschman, 1988).

It is the concept of 'rural development' that provides the necessary space for fostering the development impact of such linkages and allows for a more active role of institutions in shaping the content of development. In line with that thinking, rural development encompasses a broader spectrum of activities than agricultural development alone. While the focus of agricultural development is mainly on expansion and modernization of farm activities, rural household is at the centre of rural development policies. Rural development strategy needs to take into account potential contribution to development by various actors like households, representatives of civil society, various state agencies involved in rural development programmes (Dethier and Effenberger, 2011). In its reach, it goes beyond farms and their

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<sup>15</sup> Theodore W. Schultz, Nobel Prize Lecture, [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1979/schultz-lecture.htm](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1979/schultz-lecture.htm); Retrieved on July 11<sup>th</sup> 2013

structures and into wider social space occupied by diverse actors from public, private and third sectors. As a result, this new notion of development goes well beyond simply aiming to increase the productivity of the family farm and includes, among other things, greater diversification of off-farm activities and it attaches a greater importance to development dictated by local needs and delivered through mobilization of local resources.

The evolution of the concept of rural development went from being conceived as a community based effort focusing primarily on bringing the issues of development to its direct beneficiaries even in its inception phases (Holdcroft, 1978) to “integrated rural development” approach focusing mainly on reducing rural poverty (Dethier and Effenberger, 2011), and finally to proposing various market oriented measures in line with the economic ideology of the 1980s.

The wider notion of rural development and how it is being translated into actual policy is not without its critics. The critical views most notably single out the policy makers’ neglect of the composition and structure of rural areas. Smallholders, who still constitute the vast majority of developing world’s rural areas, had been unable to adjust themselves to the requirements of free market forces (Lele, 1975). This inability to adjust to free market requirements became particularly problematic for small farmers in countries with socialist past. Not only did they face formal limitations that affected their ability to appear competitive in a free market context (most notably their farm sizes which in turn affected the ability to reach economies of scale), but they also faced a set of attitudinal issues rooted in norms and values of socialist times that prevented them to innovate and become more competitive. This latter constraint can perhaps be ascribed to path dependency mechanisms that were at work in most of these countries in which agriculture was subjected to different collectivization techniques during the socialist regime and often perceived as an underperforming sector. Formal application of market enhancing measures to such context is of little help, as it will be shown in later parts of this thesis.

In line with the shift of focus from simply agricultural to rural development explained above, De Janvry (2010: 18) argues that a “renewed attention to agriculture cannot be implemented by returning to the classical paradigm of development economics” and it certainly needs to take into account that current development objectives are now extended to include not only agricultural growth but various off-farm and cross-sector activities. To that end, he claims, the response to the need for paradigm shift in the field must come in a form of a complete reconceptualization of the role of agriculture in order to account for the new objectives of development. De Janvry stresses the need for all actors, be they private, public, or third sector actors to get involved in redefining the meaning of agriculture for development. Such insights resonate well with Stiglitz’s (1986; 1987) argument regarding the intervention of state in agricultural markets. The actual intuition made by Stiglitz and worth noting here is that the mere existence of market failures does not in and of itself mean that government intervention

will serve as a remedy. On the contrary, the existence of market failures is to be understood first in terms of its causes and then responded to by appropriate government policy instruments or not responded to at all. A legitimate question to be raised here is whether there exist an alternative way to correct market failures in agriculture other than government policy intervention? And if intervention is necessary, what acts of intervening would not jeopardize much needed interaction between public, private and third sector actors in redefining the content of rural development?

These questions will be tackled in the later parts of the chapter and in the reminder of this thesis. Their basic intuition, however, is worth noting here: A new conception of development in rural areas must allow the plurality of influences, both institutional and structural, to shape its borders and its content. In line with that, the following section provides an overview of the NIE contributions to discussion on determinants shaping development by shedding light on factors previously disregarded in the analysis of economic development and change, namely the role of institutions.

## New Institutional Economics: bringing dynamics to the analysis of institutions

Institutions, institutional structures, and institutional environment condition the choices people face in any economic system. This means that institutional arrangements have direct bearing on economic efficiency resulting from the choices made. The mainstream economics has rarely, if at all, given the due scholarly attention to the notion that institutions can either undermine or assist the functionality of economic relations among various agents in economic systems. Instead, its analysis revolved around and relied on the resource allocation paradigm, forces of demand and supply, and price mechanism all the while assuming the perfect rationality of humans. In the words of Williamson (2000), the mainstream economics approach was 'institutions-free' economics for it disregarded the clout institutions have in shaping and directing actors' choices.

The change of focus towards not only recognizing the importance of institutions but also analysing them came first in the form of old institutional economics (OIE) and later in the contributions of the new institutional economics. The two are similar to the degree that they share the view on the importance of institutions for understanding the overall dynamics of economic systems. However, they differ in how they approach the analysis of institutions.

In fact, the representatives of the OIE branch barely went beyond criticizing the lack of focus on institutions within the field of the mainstream economics. The greatest contribution of the OIE lies in bringing the institutions into the discussion on economic change and in placing the greater focus on how norms and values shape human economic behaviour (Hodgson, 2000).

Most commonly, the OIE tradition was criticized for its lack of meaningful positive research outlook (Coase, 1984; Matthews, 1996 cited in Williamson, 1998). However, in spite of criticisms, theoretical questions raised through the OIE research programme were immense in their importance and reach (Hodgson, 1988; 1998; 2002) and have eventually led to a new, more refined and focused approach to studying institutions through the NIE research agenda. In this sense, Williamson (2008) is right to claim that there are no failed approaches to studying anything for each attempt is a step closer to understanding the larger picture of phenomena. That implies the the NIE research agenda is the product of ‘an evolutionary process’ (Brousseau and Glachant, 2008: xxxix). Apart from being characterized as ‘an idea whose time has come’ (Williamson, 1998: 75), the NIE shows that not only do institutions matter but they can be vigorously analyzed. Briefly, it is defined as a study of “institutions and how institutions interact with organizational arrangements” (Menard and Shirley, 2005:1).

However, despite scholarly interest in the field there is still no consensus as to the true meaning of its basic conceptual components, thus difficulty with understanding and defining the real boundaries of institutional economics. Sometimes, the term ‘institution’ is used to depict a framework of laws and customs, while at other times it serves to denote the behaviour of actors (Commons, 1931). In fact, almost embracing the both sides of the same coin, “an institution is defined as collective action in control, liberation and expansion of individual action.” (Commons, 1931:648) Institutions are at the same time constraining but also enabling mechanisms. They constrain in order to enable. In an attempt to highlight the self-reinforcing nature of institutions Hodgson (2006: 7) argues that institutions rely on what he calls the ‘reconstitutive downward causation’ in how they not only constrain but also frame and change individuals’ aspirations. The reconstitutive downward causation also explains the dependence of institutions on individuals and their mutual interaction which renders institutions both “objective structures ‘out there’ and subjective springs of human agency in the human head.”(Hodgson, 2006: 8)

Contrary to the OIE tradition, the analysis of institutions and their determinants in the spirit of NIE need not entail the rejection of the important assumptions and instruments of inquiry of neoclassical economics. It does, however, highlight the need for what were previously thought to be uncompromising postulations of neoclassical economics to be somewhat relaxed and cognizant of humans’ many limitations, especially in institutionally complex and challenging settings where humans attempt to jointly coordinate their behaviour. (Ostrom et al., 1994)

The sections that follow present the main NIE contributions to the study of economic change and development.



## On rationality of economic actors

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Still operating within the frame of individual freedom to choose among the alternative behaviours the one that will most effectively maximize the set preferences (Eggertson, 1990), the NIE argues that human decisions are not fully rational and human actions are susceptible to influences coming from their values and norms (North, 1995). This was an important contribution as it recognized that, contrary to the neoclassical tradition's view of perfectly rational utility maximizing actor, the complex world of numerous actors' interactions makes it very difficult to predict all of their individual choices. This is partly so because the choices actors make are not derived from their perfect knowledge of circumstances but rather from continues 'trial and error' type of behavior and 'implementation of solutions that should be recognized as imperfect' (Brousseau and Glachant, 2008: xl). Because of this, the design of institutional systems is continuous and ever evolving.

Building on the previous point, humans are incapable of perfect rationality first and foremost because their access to information is limited. This is true because of at least three reasons. Firstly, actors' ability to gather all relevant information in order for a perfectly rational decision to be taken is certainly physically limited regardless of technological advancement of our society. Secondly, obtaining information is costly and the transaction costs incurred in the process need to be fully recognized (Menard and Sherley, 2005). Gathering information is even costlier when skills necessary to collect and process relevant information are missing. Thirdly, information is sometimes withheld on purpose or given in a biased and partial way for reasons of strategic, opportunistic nature which often happens in situations where there are asymmetries and/or diverging interests.

Information can surely in and of itself be considered a strategic factor of production, especially for sectors that are inherently risky like agriculture. However oftentimes, it is, wrongly, assumed to be of secondary importance to other factors of production. If information is essential to rational decision making, then the difficulties surrounding the process of information gathering do diminish the capacity of actors to make perfectly rational decisions.

For that reason, the NIE agenda operates with a more realistic assumption of 'bounded rationality' (Simon, 1972) which recognizes various limitations stemming from actors' cognitive characteristics and the characteristics of the environment that both effectively constrain actors' ability to assess all knowledge necessary and humans' limited ability to process the information in due time so that a fully rational choice can be made (Williamson, 2000).

## On transaction cost and governance mechanisms

Interactions among economic actors come at a certain cost which is tied to a transaction being carried out among them. The mainstream economics failed to recognize the existence of this positive transaction cost. This was pointed out in the 1937 Coase's seminal article "The Nature of the Firm". In that contribution, Coase maintains that although economic activity can be organized in various forms, firms and markets for example, these forms are not to be taken as pre-existing or exhaustive. There is a choice between markets and firms, and perhaps more importantly there is an alternative to both. Whether individuals choose to organize their economic activities through one form over the other very much depends on their estimation of costs associated with carrying out a transaction under all available alternatives (Masten et al., 1991). Aligning the nature of transaction to the governance structure most suitable to economize on associated costs was alien in a 'strange world of costless transaction' (Furubotn and Richter, 1997:8).

Coase's argument concerning the transaction as a unit of analysis was groundbreaking inasmuch as it brought the concept of the 'firm' under closer scrutiny. It did so by suggesting that the firm is nothing but a 'governance structure', and one of several possible structures that enable actors to take control over their costs (Williamson, 1998: 75). While Coase also recognizes that each actor inherently wishes to economize on transaction costs, he points out that there is more than one way to do it and it is the choice of the governance structure that needs to be aligned with the nature of the transaction in order to economize on costs. The whole point of scrutinizing the firm is to show that there is both logic and consequence of its internal structure (Williamson, 2000).

The reasoning presented in Coase's contribution prompted Williamson to further operationalize the study of transaction cost economics. This was done through his well-known 'discriminating alignment hypothesis'. The basic reasoning behind the hypothesis is that managers should align the governance structure of the firm with exchange attributes of transaction in order to cut down transaction costs and as a result achieve better performance (Nickerson and Bigelow, 2008:186). There are three basic dimensions of transactions that are of importance to the choice of governance structure and consequently to performance, and they are: asset specificity, uncertainty, and transaction frequency (Williamson, 1975; 1985). Misalignment between any of the three dimensions of transactions with governance structure may produce high transaction costs and reduce the ability of an enterprise to survive in the long run. This is the essence of the transaction cost approach.

As it was established in one of the previous points, the institutional environment within which transactions among actors occur is unstable and constantly evolving. Therefore, the role of governance structures, apart from minimizing transaction cost, is to protect actors against

unforeseen eventualities that arise out of incomplete knowledge and information and consequently out of incomplete contracts. In this sense, the role of institutions is to reduce the systemic uncertainty created by limited information and potential opportunistic behavior.

### On the importance of property rights

When compared to the NIE's broader treatment of the idea of 'market', the neoclassical view of market as a price mechanism that connects actors to one another appears to be silent on the institutional conditions under which markets function efficiently. Menard (1995: 163) argues that institutions, markets and firms are central concepts in the NIE analysis and that their better understanding requires a recognition that they operate at different levels. He further contends that institutions, operating at a higher level than markets and organizations, enable their functioning in a sense that they devise the rules of the game the task of which is to create an incentive structure to guide the behaviour of actors. However, in a zero transaction cost world of the neoclassical economics, as Menard argues, a lot of important institutional factors are left unspecified due to an overwhelming focus on the function of the market as price mechanism.

The crucial factors that make the functioning of the market possible and efficient are properly assigned property rights and clearly defined enforcement mechanisms (Menard, 1995). In fact, property rights and how they are assigned can be an important determinant of economic efficiency. Barzel (1997) distinguishes between economic and legal property rights recalling the work of Alchian (1965; 1987) in defining the economic property rights as an individual's ability to enjoy a property while the legal property rights represent an instrument through which the economic property rights are reached and defended. In Barzel's view the legal property rights are a support system of rights recognized and enforced by the government. Their role in principle is to enhance the economic property rights.

Why the neoclassical view of markets as price mechanism matters in understanding the role of property rights? First and foremost, "in order to carry out a market transaction, it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up a contract, to undertake the inspections needed to make sure that the terms of the contract are being observed, and so on" (Coase, 1988: 6). What is implicitly implied in this statement is that the exchange that takes place within a price system is not simply that of goods and services but also of property rights attached to them, which in turn means that the transfers happening through the market are reversible, i.e. buyers can become sellers and vice versa. Consequently, there is a price to be paid for the transfer of property rights. Lastly, this price, or rather the cost from the point of view of those seeking the information necessary to make a transaction can actually

render the transaction too costly to perform, thus directly affecting the functioning of the market.

Therefore, following from these insights, positive transaction cost results from determining the right over property, transferring it, and protecting it. With transaction costs being positive, property rights will never be fully delineated resulting in less than optimal resource allocation. This is a result of a costly process of determining some attributes of an asset (Barzel, 1997). Similarly, resource allocation can be efficient and independent of the ownership structure only when there is a perfect delineation of property rights and transaction cost is zero (Coase, 1960).

To conclude, not clearly delineated property rights and property rights whose determination and transfer become too costly have a direct impact on the ability of markets to allocate resources efficiently. This clearly points to the importance of institutions for efficient functioning of governance structures.

### Institutional levels and their interactions

As it can be drawn from the previous points, authors recognize the existence of various kinds of institutions and subject them to a number of analytical approaches. For example, in a broader fashion Williamson (1998) distinguishes between two useful levels of analysis that are generally recurrent in the NIE scholarship. In his view, there are macro and micro levels of analysis that concern the NIE scholars. The institutional environment, as he calls the macro level of analysis, represents institutions in North's sense, which is to say that institutional environment equals the 'rules of the game, polity, laws of contract and property' (Williamson, 1998:75). The micro level, on the other hand, is what Williamson (1998) calls 'institutions of governance' or 'play of the game – the use of markets, hybrids, firms and bureaus'. In other words, these are governance structures.

Although often analyzed separately, the two levels have a great deal of influence over one another, especially when analyzing economic development. In his more recent work Williamson (2000) further explained the complexity of a 'society to institution' interaction by using the four levels of social analysis – thereby expanding his earlier thoughts on the NIE subject matter and clearly placing both property rights approach and study of transaction cost within the appropriate levels of analysis.

Table 3 Levels of social analysis

Level	Rate of Change	Purpose	Field of study
<b>Level 1:</b> Embedded, informal institutions, customs, traditions, norms	Slowest to change; Between 100 and 1000 years	Develop spontaneously, noncalculative	Economic history and economic sociology; contributions from the OIE school; often taken as given by most scholars
<b>Level 2:</b> Institutional environment: formal rules of the game, politics, judiciary, bureaucracy	10 to 100 years	Get the institutional environment rights; 1st order economizing	NIE contributions; especially the property rights theory and positive political theory
<b>Level 3:</b> Governance - play of the game; contracts; alignment between structures and transactions	1 to 10 years	Get the governance structures right; 2nd order economizing	NIE contributions - study of contracts and transaction cost analysis
<b>Level 4:</b> Resource allocation and employment - prices and quantities; incentive alignment	Continuous	Get the marginal conditions right; 3rd order economizing	Neoclassical economics contributions; microeconomic analysis of firm as a production function

Source: Adapted from Williamson (2000: 596-600)

Williamson proposes that the interconnectedness between the four levels of social analysis is such that every level affects the level immediately below it in a manner of constraining it. There are of course feedbacks from the lower level to the one immediately above but those are not considered in the Williamson's argument. Noting that we are still far from comprehensively understanding the dynamic that underlies the evolution of institutions, a situation partly to be blamed on the dismissive attitude towards institutions still present in the neoclassical economics, Williamson reiterates North's argument regarding the slow pace of institutional change at the first level, that of informal rules and cultural norms. But they both fail to provide a clear answer as to why the change at this level is so slow. Williamson (1991:111) himself cites North's question: "What is it about informal constraints that gives them such a pervasive influence upon the long-run character of economies?" The informal institutions, or the social embeddedness can take several forms ranging from cultural, social, political, structural, and their strong grip over the nature of social and economic behaviour of actors in a society is yet to be explained by an overarching theory (Smelsers and Swedberg, 2010).

From the informal rules of the first level, social analysis at the second level moves into the area of formal procedures and considers the role of political system in designing conditions for economic change and development. Second level, as argued by Williamson is slightly more susceptible to designed change though "cumulative change of a progressive kind is very difficult to orchestrate" (2000:598) and takes up to a hundred years to change. Probability of inducing the 'cumulative change' can occur, albeit rarely, in events like regime change, political and

economic crises, occupations, break up of territories, etc. Representing the notion of institutions as 'rules of the game' in North's sense, this level combines the effect of various branches of government, bureaucratic and power relations across these levels on the functioning of the system as a whole. The second level of social analysis here is what Williamson in his earlier research called a macro level of NIE analysis. Property rights regime and corresponding contract laws signify the gist of this level of analysis.

The institutions of governance are located at the third level and their importance to the NIE scholarship cannot be stated strongly enough. At this level of analysis, it is quite clear that the governance of contractual relations and corresponding transaction costs incurred by contractual parties should be the centre of analysis. Scholarly contributions highlight the need to study the alignment between the governance structure and the nature of transaction cost when designing economically efficient and adaptable organizations (Commons, 1932; Coase, 1937). Governance structures, along with ownership arrangements that reflect their relation with the nature of the transaction itself, also affect the incentive formation (Williamson, 2000).

Finally, the fourth level of analysis depicted by Williamson is where the neoclassical analysis of prices, optimization mechanisms and firms as production functions takes place. This level is in fact seen as an 'outcome of the institutional infrastructure' (Williamson, 2000) and the analysis of consequences of previous institutional choices made either by chance or by design is at its centre. The change at this level happens almost routinely and continuously as actors alter their choices in response to everyday changes in their environment. Clearly, the NIE scholarship concerns itself with analyzing the second and third level of the proposed four levels of social analysis. It focuses on how the respective levels interact in complex processes of economic change.

Two important general insights arise from Williamson's attempt to explain the structure of social analysis and to place the NIE contributions within it. Firstly, the bounded rationality of human actors, which is one of the basic assumptions of NIE scholars, causes complex contracts to be unavoidably incomplete. However, absent a proper mechanism to control the consequences that may arise out of incomplete contracts even the most thought-through contracts become inadequate as they cannot counter balance problems with opportunistic behaviour, moral hazard, shirking etc. This further accentuates the importance of a governance structure as a mitigating device in the face of contract specific uncertainties. Additionally, as contracts are not self-enforcing there is a need for a credible institutional mechanism for their enforcement.

Secondly, hypothetical organizational ideals function only in theoretical papers. Everything else that falls short of the organizational ideal falls into the category of feasible but imperfect alternatives. Through positioning different strands of the NIE within his proposed framework,

Williamson points to the need to reconsider replacing a one dimensional view of the economic actor as assumed by the mainstream economics with new multidimensional and multidisciplinary lenses that reveal a far more complex entity that ought to be studied. What follows is that 'getting the institutional environment right' is harder than it sounds and it requires an alignment of sorts with all other levels of analysis presented here. Additionally, the functionality of the alignment will certainly depend on the presence of the institutional trust. Realizing this and employing the public policy to these ends may help mitigate some of the sector specific risks as the next section briefly explains.

### Agriculture and NIE: the space for public policy intervention

There are ample ways of using the NIE insights to explain the changes and dynamics in the agricultural sector, and especially in the contracting sphere (Cook et al., 2008). Given an increase in number of vertical linkages formed across the food and agricultural sector in the recent decades, there is a growing interest among scholars in exploring the coordination mechanisms and governance structures thus created among different parts of the value chain (Royer, 2011). The transaction cost economics provides invaluable lens through which such dynamics can be analyzed.

Cook et al. (2008) argue that due to a number of specificities pertinent to agricultural sector such as its seasonality, high asset specificity and perishability of goods produced, the actors in this sector have devised a variety of specific institutional arrangements to help them deal with a number of hold-up problems. This has led to the introduction of hybrid governance structures with diverse levels of formalization. Analysing the hybrid governance structures has proven useful in understanding the important relationships between input suppliers, producers, processors and distributors in agriculture. An instructive assessment of the costs associated with the innovativeness in governance structures in agriculture came through the TCE and shed a new light on concepts like risk, asset specificity, quality control, and uncertainty in agriculture (Cook et al., 2008).

Employing the NIE insights reveals a number of areas where active government role through policy can bring about improvements in development of agriculture, and especially in countries with relatively unstable institutional environment. Firstly, through 'getting the institutional environment right' state institutions can set the basic framework within which the plurality of organizations in agriculture can flourish. The NIE insights reveal that the question of development is a matter of complementary and simultaneous evolution of both 'rules of the game' and 'play of the game'. Long term development in all its forms and with structural ramifications does not depend on whether the rules of the game exist or not but rather on their

quality and ability to combat the inherent limitations of rationality of all actors involved. This is particularly important for developing countries.

Furthermore, public policy must be cognizant of the fact that “all feasible forms of organization – government included – are flawed” (Williamson, 2000:601). Therefore, Williamson argues that the role of public policy is to supply the best alternative of all available forms of organization while ensuring that cost of implementation is also factored in the assessment of the chosen form.

However, to understand the dynamics between institutions and third sector enterprises it is not enough to rely on institutionalist explanations only. Third sector economics’ insights are invaluable in understanding the nature and development impact of cooperatives.

## Third Sector Economics: Correcting government and market failures or more?

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From the 1970s onwards, when the term ‘third sector’ was first coined by Etzioni in his ‘The third sector and domestic missions’, the very conceptual idea behind it was subjected to various views and arguments particularly pertaining to its demarcation with other two sectors, namely private and public. Due to this, Corry (2010) termed it a ‘residual’ sector, explaining that such a label comes from the name itself signifying a collection of organizational forms that fall neither in private nor in public sector. Such a status led to the sector not being susceptible to a systematic scrutiny for fear of losing some of its defining qualities such as “voluntary participation, value-based motivation, and independence from more institutionalized power structures” (Corry, 2010:11).

Generally, literature recognizes that the third sector refers to “an alternative sector separate from and balancing the state and the market” (Corry, 2010:13). Although succinct and useful, this definition overlooks an important function of the third sector, that of a corrective of a multitude of market and government failures, particularly in agriculture. Therefore, its role is not simply that of balancing the two sectors but also of generating the provision of and access to services that would otherwise be unavailable and inaccessible. Some have argued that the sector itself is “by nature unsuited for singular definitions” (Osborne in Corry, 2010).

Although American and European definitions of the third sector differ to some degree, specifically on the inclusion of cooperatives in third sector (Borzaga 1998; Evers and Laville, 2004), the underlying argument of all schools is that there exist a set of services that both market and state alone fail to successfully provide which necessitates the emergence of alternative organizational forms, self-help groups and various other types of voluntary organizations that seem to have the capacity to fill the missing gap in service provision.



Suffice it to note at this point that the European approach to understanding and indeed defining third sector organizations values more 'historical-dynamic' processes specific to any region/country in understanding the types of organizations that emerge within these divergent contexts as opposed to the U.S. led approach that tends to overlook the impact of these contextual specificities. As a result, the very definition of third sector organizations, based on the 'non-distribution of profit' criteria alone prevalent in the American understanding of third sector organizations risks being American-biased (Borzaga, 1998).

Certain sectors of economy have historically been more conducive for development of third sector organizations than others. As contended by Valentinov (2005), agricultural production in countries with highly fragmented agricultural market is a case in point. Not only does cooperative arrangement in agriculture offer an alternative way to internalize otherwise externalized transaction costs in agricultural setting (Valentinov, 2007), but it can also play a dual role, namely economic and social, in socially diverse and heterogeneous environments (Bonus, 1986). Using the notion of 'rurality' to denote specificities of rural context, Valentinov (2008) proposes that insights from both theory of the third sector and transaction cost economics be combined in explaining the emergence and role of third sector organizations, cooperatives included. His approach is novel inasmuch as it helps highlight "the specific institutional identity of the third sector as different from the for-profit sector" (Valentinov, 2008: 13) and it does so by taking into account limitations to the division of labor in the rural context and presents the third sector organizations, and more specifically their self-sufficiency, as a remedy to these limitations. Recalling the contributions by Smith (1981) and Becker and Murphy (1992), Valentinov argues that efficient division of labor in agriculture is limited both by the extent of the market and transaction cost itself. Since the theory of division of labor suggests that there are essentially two ways for actors to satisfy their preferences, namely exchange and self-sufficiency, and since in the rural context simple exchange is deemed too costly actors turn to exercising self-sufficiency through third sector organizations (Valentinov, 2008).

Similarly, proponents of the third sector economics and specifically those advocating the importance of agricultural cooperatives in rural development argue that third sector organizations with their structure and 'not-for profit' orientation not only fill the gap that emerges as a result of various market and government failures in agricultural market but also show the capacity to go beyond simply fixing the market failure and are indeed capable of providing a well-rounded conception of development (Borzaga and Defourny, 2004; Evers and Laville, 2004). For that reason, the following section outlines the basic organizational characteristics of cooperatives as organizations that can advance the new notion of development.

The place of cooperatives in the study of the third sector economics

Third sector organizations as defined in 2011 Report of the European Economic and Social Committee include a variety of organizational forms, such as cooperatives, mutual societies, social enterprises, associations and foundations.

Although the form and purpose of different organizations of the third sector differ from one member state of the EU to another due to a host of political, historical and social factors, they seem to have received a much needed recognition of their importance in upholding the social model in the EU market. This specifically refers to cooperatives as they appear to be an important part of the history of social economy development in Europe and their study has added to the third sector analysis an economic perspective – a reflection of an entirely European approach to studying third sector organizations.

Following the U.S. approach, cooperatives fall outside of the third sector reach (Salamon, 1996) while in the European tradition they are studied as a part of the social economy of the European continent (Evers and Laville, 2004). The U.S. view of cooperatives as functioning outside of the third sector framework relies mostly on the possibility left to cooperatives to redistribute some part of their annual surpluses to their members, and this, in the American tradition of understanding cooperative enterprises, violates the principle of non-distribution of profit (Salamon, 1996).

Contrary to this view, Gui (1991) argues that one needs to look into the original motivation behind the formation of cooperatives and suggests that cooperatives, as mutuals, are formed to meet the needs of their members and not to maximize profits and redistribute them subsequently. This view resonates well with the argument put forward by Defourny (2014) that focuses on two distinct dimensions to help differentiate third sector organizations from those that populate other two sectors: their productive purpose and internal organizational structure. This should be the criteria on which cooperatives should be judged for their third sector membership. Furthermore, in some countries, such as Italy, specific legal regulations prescribe the limits to profit distribution in cooperative sector (Borzaga, 2004 In Evers and Laville, 2004).

Table 4 Differences in European and American view of third sector organizations

<b>'European' definition of the third sector</b>	<b>'American' definition of the third sector</b>
<ul style="list-style-type: none"> <li>• Emphasis on an analytical approach developing association typologies and changes as well as the development of the economic dimension of all 'not-for profit' social economy organizations.</li> <li>• Criterion on limits on private acquisition of profits: inclusion of cooperatives and mutual aid societies.</li> </ul>	<ul style="list-style-type: none"> <li>• Emphasis on a classificatory approach and centred on a statistical interpretation of the importance of a sector comprising all non-profit organizations.</li> <li>• Non-distribution constraint central: exclusion of cooperatives and mutual aid societies.</li> </ul>

Source: Evers and Laville, (2004:13)

## *Defining a Cooperative?*

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Most of the literature on cooperatives in agriculture acknowledges the heterogeneity of interpretations and views on the definition of cooperatives, their role in rural development and specifically the measures of their success (Koller, 1947; Van Dooren, 1978, 1982; Hansmann, 1980; Staatz, 1987, 1987a; Centner, 1988; Barton, 1989; Hind, 1997; Chaddad and Cook, 2004).

In its 1995 Statement on Cooperative Identity, International Cooperative Alliance (ICA) defined a set of principles and values of cooperation offering a broad definition of a cooperative:

*A co-operative 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 (ICA, 1995).*

There are seven principles of cooperation that support the ICA's view of cooperatives, namely: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; co-operation among co-operatives; concern for community. Their importance is of different degree and their implementation is not obligatory but rather they serve as a broad framework for creating cooperative-friendly legislative and policy structures.

Several decades ago, in his work on cooperatives Van Dooren (1978;1982) documented the existence of more than twenty different definitions of cooperatives covering more than forty divergent areas of their functioning. Not much has changed from then until now in terms of scholars' attempt at generating a single, succinct definition of cooperative. On the contrary, in the years that followed Van Dooren's analysis new socio-economic conditions have given birth to innovative cooperative forms especially in the countries that broke away from socialist economic tradition in the 1990s and, faced with market competitiveness, had to reconcile their previous mode of functioning with sophisticated demands of the market.

The existence of multitude of definitions is not simply an illustration of scholarly disagreement on what cooperative is or should be in the context of market economy but it is more a testimonial to the complexity of the phenomenon in question. Furthermore, drafting a conceptual ideal of a cooperative would create additional problems related to measuring success of existing cooperatives. The host of varying definitions is insightful, however, of "capacity of cooperatives to assume a number of forms consistent with socio-economic environment in which they are situated" (Borzaga and Spear, 2004:3).

Craig's definition of cooperatives and cooperation provides a succinct view of this enterprise's main features (1993:43):

“Co-operation is the free and voluntary association of people to create an organisation which they democratically control, providing themselves with goods, services and/or a livelihood rather than profiting from others, with an equitable contribution of capital and acceptance of a fair share of risks and benefits generation by the joint activity.”

In his definition Craig highlights an important aspect of cooperative governance arrangement, that of risk-sharing. Indeed, in volatile and highly risky sectors such as agriculture, risk-sharing may arguably be one of the most important advantages of cooperatives, especially for small farmers (Sexton and Iskow, 1988; Craig, 1993).

After giving an overview of the cooperative principles most frequently found in the literature Dunn (1988) points towards an important divide that must be made between cooperative principles and supporting practices when attempting to define a cooperative enterprise. He argues that three important principles define all cooperative organizations: “the user-owner principle, the user-control principle, and the user-benefits principle” (Dunn, 1988: 85) and they are to be distinguished from what are mere cooperative practices related to cooperative internal structure, decision making processes and revenue distribution practices. In explaining the uniqueness of three main cooperative principles he goes on to suggest that they are derived mainly from a dynamic relationship that exists among interests associated with users, owners, controllers, and employees in any enterprise. Such an approach clearly gives priority to understanding the enterprises' purpose and its orientation towards its main users over the non-profit distribution constraint for example.

Dun's view of cooperatives is useful inasmuch as it highlights the core and essential 'ownership-control-benefits' axis that characterizes cooperative enterprises. It can be argued that much of the benefits generated by cooperatives for small farmers come exactly from the fact that owners of the enterprise do not differ from users of its services, which among other things functions as a guarantee of service quality provided through cooperative.

#### *The cost of setting up and running a cooperative*

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There are, of course, certain reservations in the literature as to the ability of collectively owned enterprises to keep operational costs under control with Hansmann (1988) arguing that these costs are most certainly going to be higher in cooperatives than in corporations. There are

several kinds of costs that are usually related to the cooperative specific structure of ownership and governance. The following are the most significant ones.

#### Monitoring and Supervision Costs

On the issue of costs specific to cooperatives, Menard (2004) also argues that cooperatives must incur costs related to monitoring and supervision which can be quite high because of large membership and multi-stage production processes. However, another strand of literature argues that cooperatives, being a collective community of individual farmers, retain the ability to keep monitoring and supervision costs under control precisely through their members who perform these functions on their own individual farms (Valentinov, 2007; Valentinov and Iliopoulos, 2012). In this context, it can be argued that with regards to operational costs of monitoring and supervision a cooperative is much more than just a sum of its parts. Rather, a cooperative can be seen as a functional network of its parts in which every individual farmer retains the advantages of family farming while exploring the benefits of using joint resources and achieving larger production volumes. This is precisely what Bonus (1986) termed centripetal forces, i.e. the benefits of being part of collective organization, and centrifugal forces or benefits of retaining independent operations, and both of these need to be at work for a cooperative to be a functional business enterprise.

#### Property rights problems as a source of cost

Under the pressures from the market, however, agricultural cooperatives tend to exhibit a number of internal constraints that limit their ability to function as an effective decision making organization (Iliopoulos and Hendrikse, 2009). As a result of their inability to deal with competitive pressures cooperatives tend to experiment with introducing variations to the core cooperative model, or exit the market altogether. Chaddad and Cook (2004) analyze these variations in how property rights are allocated in a cooperative and suggest that cooperative can either be of traditional type or move anywhere from allowing external investor into the structure to being a real investor-owned firm at which point it ceases to be a cooperative. The problems that are most often cited to lead to this movement away from traditional cooperative form towards more investor oriented firm range from free rider problem, horizon and portfolio problems, control problem and influence cost problem (Tortia et al., 2013).

#### Incomplete contracts as a source of cost

Creating clear contracts is one way of dealing with unforeseen costs but more so with uncertainties that come with organizing various transactions. Although contracts are one of the most important institutions of market economies they are incomplete by nature and can only predict limited number of events and situations. In essence, contracts are a simplification of reality and because of that “the choice of governance structure that can adequately complement

contracts and contribute to their implementation becomes crucial” (Menard, 2004: 352). Adopting a governance structure that fits best the circumstances and nature of transactions is in fact an important guarantee that the innate incompleteness of the contract will not translate into an additional cost. Since hybrids are neither markets nor hierarchies (Williamson, 1991), their characteristics tend to be aligned with the nature of transaction they set out to organize (Menard, 2004). This makes the hybrid forms of organizations better suited than either markets or hierarchies to complement the contracts that regulate their specific transactions and consequently reduce or at least prevent the increase of transaction costs.

### *Why choose a cooperative governance structure?*

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Among the most commonly cited reasons for setting up cooperatives is a range of market failure situations which they have the capacity to correct. More specifically, the choice of cooperative business model is easiest justified under the condition of oligopsony, a situation in which there are more sellers than buyers which is oftentimes associated with agricultural sector. In such situations farmers may be put to disadvantage in terms of the price they receive for their product. Organizing a cooperative so that market power of certain agents is circumvented is a legitimate and justifiable action on part of farmers. After all, as pointed out by Sexton and Iskow (1988:6), “cooperatives do not replace market exchange. Rather, they harmonize exchange”.

Furthermore, cooperatives are important where knowledge of and trust among business partners features significantly into the business processes (Centner, 1988). Indeed, the presence of social capital enhances the productivity of cooperatives (Hong and Sporleder, 2013). For individual farmers a cooperative itself is a source of social capital. That a firm in its own right is a social capital is not a new idea (Anderson and Jack, 2002).

Additionally, horizontal and vertical integration through cooperatives is a means for small farmers to overcome the constraints of limited resources. Though this kind of economic power augmentation is viewed with caution due to its potential monopolistic ambitions in the case of agricultural cooperatives these fears are rarely, if ever, legitimate. To be successful in meeting their members’ specific social, economic and advocacy needs cooperatives usually remain rather localized and rarely attain the level of economic power that would constitute a genuine threat to competitive nature of the market (Hirsch et al., 1950).

Cooperatives are an important part of capitalistic economy and are neither strange nor antagonistic to it. On the contrary, their success depends on respecting a number of market enhancing concepts such as ownership of property, clarity of contracts all the placing the individual farmers’ needs and not the profit at the centre of their activities (Koller, 1947).

Indeed, their ability to perform some of their economic functions depends on healthy competition from other market actors and in that sense, good cooperative management occupying a strategic market place coupled with sound market stimulation can only be an advantage (Koller, 1947:1136-1143). Furthermore, Koller argues that “cooperatives provide a means of complementing and strengthening the capitalistic economy at its weakest points. While cooperation is clearly not a panacea for all the ills of capitalism, it does perform a positive role in the free enterprise economy by aiding it to achieve a better allocation of resources, higher total production, and a wide distribution of income” (1947:1444).

In a gist, agricultural cooperatives’ advantages range from empowering individual farmers and strengthening their collective market power as well as their negotiating position vis-a-vis public institutions and other market participants to providing them with the risk sharing mechanism that is fundamental in mitigating some of the acute weaknesses of agricultural sector. By organizing in cooperatives farmers create for themselves a better access to services and finances necessary to upgrade their productive capacities.

The contribution of agricultural cooperatives to rural development does not only rest on providing economic benefits to their members but derives from cooperatives’ social role as well. The social aspect or aim pursued through cooperatives is what makes the economic benefits more sustainable and magnifies their effect, especially in the long run. There are two ways in which social contribution of agricultural cooperatives can be accounted for. Firstly, cooperatives themselves provide a space for fostering trust among members and building social capital which is in and of itself a development resource. Using internal cooperative structures and democratic processes to build trust and social capital is an inward aspect of their social role. An outward aspect of cooperatives’ social role, and a much broader one, is to be found in their locally oriented investments. Agricultural cooperatives, unlike their for profit counterparts, do not move where the profit might be the highest but rather invest locally for a sustained development of their communities. In principle, their investments in local community cannot be appropriated by any one individual or sold but remain a local resource aimed to enhance the enterprising nature of the community.

Having said this, it is also important to acknowledge the difficulties cooperatives are faced with both internally and in their external relations with up and downstream partners that stem from their organizational characteristics and can work to their disadvantage. To be effective instruments of rural development cooperatives have to devise a functional coordination and governance mechanism, one that does not trade off democratic procedures and participative structures for overall efficiency. Balancing member participation and effective decision making

with economic performance can be a daunting task. A number of factors such as poor technical knowledge of cooperative members and employees, missing or underdeveloped management skills of cooperative leaders, divergent members' interests, and limited sources of capital all make running cooperatives challenging and difficult. Furthermore, cooperatives do not contribute to rural development solely because they propagate participatory decision-making but rather because they are able to turn the disadvantage of small farming into an opportunity for development through joint access to resources and equipment, better access to finances and markets. To be able to do this they do not necessarily have to involve every single member into their decision-making procedures. Indeed, this could and has proven to be counterproductive on many occasions. What mitigates the lack of efficiency in decision-making for large groups of people is made up for in well-developed, straightforward and accountable representation system and governance structure.

At the same time, cooperatives are affected by their surrounding institutional environment and their viability, both social and economic, is simultaneously affected by internal characteristics of cooperatives as well as by the existence of the supporting mechanisms in their external environment. Supporting mechanisms that can be considered external to cooperative functioning, as suggested by Patrie (1998), range from government agencies for business development, financial institutions specifically tailored to the needs of agribusiness to various other management oriented organizations aimed to assist cooperatives in their work. All of these external mechanisms function within a wider context of agricultural and/or rural development.



## Conclusion

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The insights and intuitions presented in this chapter emphasized that studying agricultural cooperatives as a rural development tool is a fundamentally multidisciplinary endeavour. In recognition of that, the chapter first presented conceptual differences between agricultural and rural development. While agricultural development rests primarily on enhancing productive capacities of family farms, the concept of rural development presents a broader vision of development that, in addition to considering the importance of productive efficiency, includes an important role of off-farm activities and various other social and political stakeholders in designing the trajectory of development. This new conception of development in rural areas points to an increasing need to hypothesize about the role of rurality and rurality specific market failures in fostering organizational variety in delivery of goods and services in rural areas. Furthermore, cooperatives owing to their participatory nature and local orientation appear to be a good mechanism in the advance of the notion of rural development.

On the basis of the argument that rural areas are indeed specific and as such under researched in their complexity by the mainstream economics, the chapter introduced the relevance of the NIE for the analysis of cooperative enterprises. The main intuition can be summarized in the following manner: All market participants seek to control or minimize cost of transacting and they do so by picking a governance arrangement that best fits the nature of the transaction. Early contributions within the NIE tradition pointed out that there is more than one way of economizing on transaction costs. It is the nature of transaction itself, or its dimensions to borrow Williamson's terminology, that dictate the choice of governance structure. Asset specificity, uncertainty and frequency of transaction are some of the features that are to be aligned with either hierarchical, hybrid or market governance arrangement in order to minimize costs and achieve better performance levels. The alignment between them happens in the context of information asymmetry and contract incompleteness which both have the tendency to increase the instances of transaction costs.

Owing to their specific governance and ownership structures, cooperatives are a unique mechanism that under certain conditions can be an effective transaction cost minimizing device which also responds well to rurality-specific market failures. However, the institutionalist approach alone is insufficient in capturing all specificities of third sector organizations in general and cooperatives in particular. To better understand the implications of third sector enterprises' embeddedness in their socio-economic context it is necessary to supplement the institutionalist insights with the views from the theory of third sector organizations especially on issues concerning the motivation to set up and run such enterprises. The value of the third sector contribution to understanding cooperatives is primarily in its treatment of cooperatives'

purposes and specific management processes employed in all third sector enterprises including cooperatives.

The underlying premise that emerges from the views presented in this chapter is that in the context of rurality specific conditions, cooperatives can be a valuable governance structure with transaction-cost minimizing capacities that aims to achieve economic stability of its members while also making localized community investments. To be able to make full use of their embeddedness in social, political and economic context cooperative internal structure needs to be aligned with a number of institutional factors in order for cooperatives to contribute meaningfully to rural development. These factors will be discussed in chapters IV through VIII.

The next chapter presents a methodological strategy of this research and details on its main hypotheses and research questions.

# Chapter III

## Research methodology

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Contemporary research on the outcomes of diverse institutional arrangements for governing common-pool resources and public goods at multiple scales builds on classical economic theory while developing new theory to explain phenomena that do not fit in a dichotomous world of “the market” and “the state.”  
(Elinor Ostrom, Nobel Prize Lecture, 2009)

### Introduction

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The objective of this Chapter is to give a short overview of the most commonly used methodological tools for studying cooperatives and specifically for estimating their economic performance. This overview of methodological approaches to studying cooperatives underscores the complexity of the “phenomena that do not fit in a dichotomous world of ‘the market’ and ‘the state’” (Ostrom, 2009).

One of the major dilemmas associated with measuring cooperative success derives from the difficulty of defining what to measure and then deciding upon the most appropriate measurement tool. Having outlined the theoretical lenses suitable to studying cooperative enterprises in the previous chapter, this chapter attempts to spell out ways in which institutional economics’ intuitions together with third sector literature contributions are employed in this research to study its main hypotheses.

In conjunction with that, the chapter describes the methodology used in this study, gives data descriptions and accounts for its limitations. In doing that, it clearly spells out the limitations of the present study as well. Finally, the chapter explains the methodology used in each one of the remaining chapters of the thesis. For better guidance through the rest of the thesis, main hypothesis as well as research questions for each of the chapters that follow will be reported here and afforded detailed discussion in relevant chapters.

## What methodological tools for measuring cooperative performance?

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Cooperative performance is not an easy concept to understand let alone measure. Because of the combination of economic objectives pursued through cooperative organization and its associational character, research on cooperative performance is often confronted with the dilemma that is primarily centred on understanding which one of the two aspects is more important, if they can be singled out for measurement at all. While the profit is a straightforward measure of success of for-profit firms, achieving financial stability is just one aspect of cooperative enterprise and often times not the predominant one. This does not mean that cooperatives can sustain themselves without achieving some level of financial success nor does it mean that cooperative members do not wish to have economic stability. Quite the contrary, in fact. In cooperative enterprises, financial stability is not an end in itself but is complemented by a number of non-monetary benefits that range from investing in local resources and engaging in participatory governance structure to mainly providing the members with a risk sharing mechanism. In unison, monetary and non-monetary benefits derived from participating in cooperatives should ideally provide for a long term partnership among individual members that rests on trust and mutuality. At the same time, the social aspect of cooperative enterprises appears to be too context dependent to lend itself to a uniform quantification. And perhaps more importantly, the social role of the cooperative changes and grows overtime as the needs of members and community evolve.

So, is it wrong to measure cooperative performance in terms of economic benefits members and non-members derive from their cooperatives? Not necessarily. However, there is no denying that such an approach does not provide a complete picture of any individual cooperative's performance and success. With an important aspect of cooperative identity missing, their full contribution to improving the well-being of their members can hardly be properly acknowledged.

There are two main reasons why social aspect of cooperatives often goes unmeasured when assessing their performance. Firstly, data availability makes it difficult to obtain even more straightforward data such as financial indicators of enterprises' activities in certain contexts. As third sector organizations are often not predominant form of economic organizations the official statistical agencies in most countries do not collect data on this side of cooperative enterprises. Secondly, there is no clarity, and therefore no agreement, as to what truly constitutes the social contribution of cooperatives. Cooperatives are in essence localized enterprises that seek to fulfil the unmet needs of a specific group of actors. Given that they are shaped greatly by local circumstances the content of their social contribution is shaped precisely by such factors. This

renders the social aspect of every cooperative very particularized and difficult to measure. While some authors look into participative structures as sources of cooperative social impact, others place greater value on how immersed cooperative is in its local community in terms of making local investments and providing employment to local people. Besides, a valuable social aim in one context may appear absolutely redundant in another. Either way, the social aspect is far more challenging to quantify than the economic aspect of cooperative enterprises.

On the other hand, measuring strictly economic performance of cooperatives has been more straightforward. Most empirical studies on cooperative economic performance can be classified into two categories: those that rely on various kinds of financial ratios and those that rely on measurements of economic efficiency with dairy cooperatives being of particular interest to researchers (Sexton and Isakow, 1988; Soboh et al., 2009).<sup>16</sup>

As for the usage of financial ratios, Soboh et al. (2009) contend that although they are indicative of a firm's general dynamism in the market expressed through profitability, liquidity, solvency, and efficiency they provide no clear link to economic theory and should be used with caution. In short, the financial ratios serve to compare in relative terms one aspect of firm's functioning to another. There are two categories of financial ratios that have been used by researchers to examine financial health of cooperatives compared to IOFs. The first category assumes cooperatives to be vertically integrated firms and refers mainly to profitability and efficiency of equity, assets and capital. The second category refers to the ability of a cooperative to finance its debts and includes the measures of leverage, solvency and liquidity ratios.

Given the difficulties associated with defining and measuring of cooperative success, researchers have resorted to simplifying the reality and viewing cooperatives as either vertical integration of firms, independent firms, or coalitions of firms (Soboh et. al., 2009, 2012).<sup>17</sup> The methodologies chosen were then defined in line with this classification.

In case a cooperative is seen as a single-objective firm (either as vertical integration of firms or as an independent firm), the most widespread technique for measuring its performance is to derive various kinds of financial ratios that can be obtained from cooperatives' balance sheets (Soboh et al., 2009).

On the other hand, the literature that views cooperatives as a coalition of firms appears to be more cognizant of cooperative structure when assessing its performance. In line with that, scholarly contributions take note of cooperatives' multiple objectives rooted in their

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<sup>16</sup> Soboh et al. (2009: 458-459) give a detailed list of empirical studies conducted for agricultural market cooperatives. It is clear from their review that most of the studies refer to the USA cooperatives and are usually focused on a particular sub-sector like dairies, grains etc.

<sup>17</sup> For details on different usage of these three distinct forms of cooperatives see: Sosnick, S.H. "A Model of Cooperative Structure and Policies." Cooperative Research Workshop and Extension Workers Conference on Cooperatives, Berkeley, CA, August 1960; Garoyan, L. "Developments in the Theory of Farmers Cooperatives: Discussion." *Amer. J. Agr. Econ.* 65, no. 2(1983):1096-98; Cook, M.L., and F.R. Chaddad. "Redesigning Cooperative Boundaries: The Emergence of New Models." *Amer. J. Agr. Econ.* 86, no. 5(2004):1249-53. Cooperative as vertical integration and cooperative as an independent firm assume the view of the cooperative as functioning with a single objective. Cooperative as a coalition of firms assumes the view that cooperative functions with multiple objectives.

heterogeneous members' interests thus identifying different groups of members ranging from extremely active to passive members (Soboh et al., 2009: 460-466). What is merely suggested by this strand of literature is that there is a multi-layered cooperative-specific structure through which financial success of cooperative boils down to its members. This happens firstly through reduction of input prices for members and through seeking the best market price for their produce and secondly, at the end of the year, through distribution of patronage refunds to cooperative members. So, in essence, the success of a cooperative is best understood as a success of its members.

In line with viewing the success of cooperatives through the lenses of farmers' individual success, Sexton and Isakow (1993) are of the view that cooperative performance can be judged on the basis of the assessment of farmers' wellbeing with or without being a cooperative member. This, they contend, can be checked from two reference points, namely the wellbeing of farmers before cooperative was formed and the wellbeing of farmers who are not cooperative members. Sexton and Isakow also highlight important effects of cooperatives' presence on the market behaviour of other actors which is known as a 'cooperative yardstick'. Other market actors can respond to cooperative presence by changing their pricing policy, offering higher prices for products or lower prices for production input. This effect of cooperatives is important yet seldom measured.<sup>18</sup>

Sexton and Isakow also warn against measures of performance such as rate of return on equity for which they argue to be a better fit to judge the success of other business organizations rather than cooperatives. In their view, the goal of cooperative is not to accumulate profit as accumulating profit would entail behaviour of the cooperative that is not in the best interest of its members (1988: 30-33).

There are also scholars who assume that there is a hierarchy of objectives pursued through cooperatives. For example, Karami and Moghaddam (2005) investigated the performance of a sample of 52 agricultural production cooperatives including 260 cooperative members using a theoretical model in which a separate set of determinants affects the success of every specific stage in the production process. They conclude that the following factors affect cooperative performance: social factors affect pre-cultivation stage, natural factors affect the stage of cultivation, government support impacts husbandry, trust among cooperative members influences the success of harvesting, and finally cooperative structure affects the post-harvest stage.

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<sup>18</sup> The cooperative yardstick effect can produce a situation in which non-members of the cooperative benefit from better market conditions, thus creating a free rider problem.

A number of empirical studies have also used techniques like Stochastic Production Frontier to estimate performance of cooperatives vis-à-vis their IOFs counterparts in the USA dairy industry in particular finding cooperatives to be less efficient than IOFs due to property rights and horizon problems (Porter and Scully, 1987).

A study conducted over a period of four years on a sample of 13 dairy cooperatives and 10 IOFs in two Indian states used Data Envelopment Analysis and Stochastic Frontier Analysis to compare their performances and found that cooperatives have shown more cost efficiency than IOFs (Singh et al., 2001). Analysing a sample of Irish dairy cooperatives for the period 1961-1987, Boyle (2004) found that they exhibit both technical and allocative inefficiencies due to principal-agent and horizon problems respectively finding little difference between cooperatives and IOFs in terms of handling the pricing.

To summarize, in the view of the above presented approaches the measurement of cooperative success depends on whether one sees a cooperative as an enterprise seeking to satisfy one or more objectives and whether these objectives are of economic or social nature or a particular mix of both. Consequently, the objectives cooperative is set to pursue will have a direct impact on the ability of its governance structure to affect the overall costs of decision-making.

One general point stands out from various studies of cooperative performance: regardless of the methodology used or aspect of a cooperative enterprise studied, the findings can hardly be generalized pointing to essentially two things. Firstly, cooperative enterprise is indeed a complex organizational construct that is not easily deconstructed for measurement. And secondly, its interaction with wider institutional structures and environment is a crucial element not to be missed when assessing overall success of cooperative enterprise.

In analyzing Philips' 1953 article on 'Economic nature of cooperative associations', Staatz (1994) summarizes a number of important research questions that can be found in the literature on cooperative performance and which help unravel the performance dilemma as well as confirm the previous two points. The questions are:

- What makes cooperatives different from investor-owned firms (IOFs)?
- Given that cooperatives are somehow different from IOFs, what operationally, should cooperatives strive to maximize?
- What are the implications of the cooperative's pursuing alternative goals for the welfare of its members and for society as a whole?
- Are there impediments to cooperatives' or members' behaving in a way that would enhance member or societal welfare?
- What are the implications of the foregoing for cooperative management

and public policy? (Staatz, 1994:80).

These questions are useful as a reminder that regardless of whether scholars view cooperatives as hybrid organizations (Menard, 2004), or business enterprises that ought to be open to flexible adjustments to their internal structure for reasons of better performance (Chaddad and Cook, 2004), or governance structures that internalize otherwise prohibitively high transaction costs (Bonus, 1986), or simply as a way to avoid high costs of market transacting and contracting (Hansmann, 1996), or a 'nexus of contractual relationships' (Philips in Staatz, 1994), or an entity whose economic success can indeed be measured in terms of financial gain of its individual members but its social impact often supersedes the individuality of membership, cooperatives are by all counts a unique organizational form. Befitting their uniqueness is an interdisciplinary approach that involves both quantitative and qualitative approximations of their success.

However, in an attempt to assess the viability of cooperative model itself, the literature has favoured economic and quantitative measures of cooperative performance over qualitative ones. In doing that, the researchers focused on the financial success of cooperatives. While insightful, such an approach unavoidably gives a partial view of cooperative success. One of the greatest risks that accompany such measurements is a complete disregard of the multidimensionality of cooperative enterprises. At the same time, it needs to be kept in mind that cooperative enterprise that successfully combines economic and social benefits is an ideal one and not all cooperatives in reality correspond to the theoretical ideal. Far from it. Depending both on the context and on one's view of the cooperatives' social dimension, cooperatives sometimes serve solely the economic needs of their members. This is even well-received in some contexts because the economic needs are the most pressing. When there is an evident lack of attention being paid to the spectrum of activities that may fall into the social dimension of cooperatives, it is justifiable that one looks into direct economic benefits members and nonmembers alike derive from doing business with their cooperative. Perhaps the way in which business is done through such cooperatives may reveal the reasons why the social aspect may be missing or is in limited supply.

In terms of measuring cooperative impact and performance on a global scale, several initiatives can be singled out. The ICA has for several years published a list of 300 most successful cooperatives in terms of their general turnover. A more comprehensive effort that goes beyond examining the turnover and includes the measures of social value came in a form of the World Cooperative Monitor Report created jointly by the ICA and EURISCE.<sup>19</sup>

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<sup>19</sup> <http://www.euricse.eu/en/node/1904>



For reasons that will be elaborated in the chapters that follow, this research does not adopt in full any of the methodological approaches discussed in this section. Instead, in line with research objectives, the approach employed in this thesis will seek to reflect the multidimensionality of cooperative enterprises in as far as that is possible given the limitations but will also take into account cooperatives' particular evolutionary experience. In doing that, it applies both qualitative methodology when studying cooperatives' interaction with their institutional environment and quantitative approach when studying the determinants of cooperative performance at an organizational level. The following section provides more details about data, its content and main limitations.

## Data Description and Data Limitation

The choice of research methodology is often, at least partially, conditioned by the type and quality of available data. Developing and transition countries are prime examples of information-poor environments in which official data on relevant economic and social (f)actors is either of low quality or altogether missing. BiH context is no exception to this. The scope of work of its official agencies of statistics reflects the constitutional structure of the country which requires high levels of decentralizations. In reality, this means that there are three official agencies of statistics (one for each entity and one state level agency). The data gathering happens within the structures of entity level agencies of Federation of BiH and Republika Srpska which then make the adapted version of data available to the state level agency.

In addition to the institutional limitations related to the process of data gathering in BiH, the content of data gathered has little policy relevance. There are only minor improvements in this regard as of recently and resulting from the conditions imposed on BiH through the process of EU integration. They mainly boil down to the recent attempt by the Ministry of foreign trade and economic relations of BiH to push forward the full implementation of the 2008 Law on agriculture requiring from lower levels of government to establish a Registry of agricultural producers and users of government services and subsidies. The Law stipulates that providing information for the Registry is strictly voluntary but it becomes a requirement if a producer wishes to apply for government subsidies. Consequently, the current Registry is not exhaustive of all agricultural actors that exist in the market but contains only the information on current subsidy users.

Additionally, from a strictly methodological viewpoint, the data in the present Registry are collected by the municipal clerks in FBiH and staff of the Agency for intermediary, information and financial services in Republika Srpska who do not share a unified data gathering

methodology. As a result, there are many inconsistencies in available data arising mainly out of methodological shortcomings and are thus of little use for a countrywide policy making.<sup>20</sup>

Because of a general lack of information on agricultural sector as well as deficiencies in publicly available data, this research is both exploratory and explanatory in nature. The data gathering process was mainly carried out in 2011. Given the scope of the research, the data for this thesis had to be gathered from multiple sources. The following is the summary of data sources. The data for empirical analysis presented in this thesis were the most challenging to gather. The financial and organizational information on a sample of 210 agricultural cooperatives were derived from three different sources:

- a) Cooperative Association of BiH Database: This database contains general information on 313 agricultural cooperatives in BiH. However, the information contained in it is rather outdated and misleading in terms of numbers of functional cooperatives in BiH. It does not delineate between active and inactive cooperatives. Since membership of cooperatives in Cooperative Association is not mandatory, it is possible that there are cooperatives which are not reported in this database. Information in the Cooperative Association BiH's database are the following: year of establishment, number of members, number of cooperants and employees, information on cooperative property (owners and users distinguished), cooperative activities, date of last audit, and kinds of subsidies/supports a cooperative receives (government, donor, etc). A contact was attempted with all cooperatives listed in this database to isolate active from inactive cooperatives.
- b) Agencies for Intermediary, Information and Financial Services (AFIP and APIF) reports: Every functioning and active business entity in BiH is under legal requirement to submit a financial report to these two entity level agencies. These reports represent the only official, and in that sense reliable source of financial data on cooperative performance. Data contained in APIF/AFIP reports are organized based on the information provided in balance sheets and consist of the following information: equity, liabilities, long and short term debts, capital, average salaries, total turnover, total expenses, profit before taxes, taxes, earnings from exports, reserves, number of employees, property and its value, land, long and short term loans, undistributed profits. For the year 2011, which was the year studied, there were altogether 260 agricultural cooperatives that reported to AFIP/APIF. However, since the data on internal organizational characteristics of cooperatives was gathered for only 210 cooperatives those cooperatives for which this data was missing were not included in the empirical analysis.

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<sup>20</sup> Information on the Registry of agricultural producers obtained from interviews with two high level civil servants at the Ministry of foreign affairs of BiH and a middle level civil servants at the Federal ministry of agriculture.

c) USAID/SIDA agricultural project database of cooperatives: The project aimed at fostering market activities in agriculture launched the first initiative to systematically collect data on agricultural cooperatives in BiH. The questionnaire used for gathering data is in the Appendix 1 of this thesis. This database contains detailed information on the organizational structure and decision making processes in cooperative sector, as well as data on cooperative property. The data entry phase for the core information on financial viability and organizational characteristics of cooperative enterprises ended in May 2011, and I personally participated in compiling parts of database that were of interest to this research. I collected additional information, more specifically on power structures in cooperatives and presence of social property in cooperative enterprises from June to September 2011. In order to gather this information I contacted by phone all cooperatives that originally supplied information to the USAID/SIDA project staff and personally visited and interviewed 32 cooperatives. The questionnaire used to gather information for this database is attached in Appendix 1.

For the purposes of carrying out the empirical analysis, these three databases were then combined into one which was then used for estimating the determinants of cooperative performance using the simple OLS regression. The year that was observed and analysed was 2011 and my sample contained 210 observations.

Other important sources of information were numerous interviews I conducted with direct stakeholders in cooperative sector as well as representatives of government institutions over an extended period of time from beginning of 2011 through 2013.

Although the Cooperative Association of BiH was unable to provide me with accurate quantitative data on existing agricultural cooperatives in BiH, their insiders' knowledge of cooperative sector was invaluable. Through a total of six interviews, four with full time staff of the Association (director, deputy director, two project managers) and two with Association's external associates helped me understand a complex relationship cooperative sector has with public institutions and fully appreciate the depth of legal problems associated with clarifying property rights in cooperative sector. Additionally, I spoke to two now former employees of the entity level associations of cooperatives on challenges specific to each of the two entities. Interview with employees and associates of the Cooperative Association of BiH were carried out in 2011, while interviews with entity level associations' representatives were carried out in 2012.

From my interview with one of the Cooperative Association's project managers I learned about the failed attempt to establish a second level cooperative in BiH. Wanting to learn more about this I got in touch with directors of twenty cooperatives that took part in this project. The initial contact with them was facilitated by the Association's project manager who was in charge

of the project and who also helped organize a focus group meeting to discuss the failure of this idea. The questionnaire distributed to them as well as group discussion questions are attached in Appendix 3. These discussions took place from September to December 2011.

Additionally, two interviews were conducted with high ranking civil servants running the Department for agriculture in the Ministry of foreign trade and economic relations of BiH. They both provided useful information on how public institutions perceive cooperatives and how they engage them in policy making process. Both of these interviews were conducted in 2013.

In the following section, I will briefly summarize the main hypotheses and research questions that provide guidance to how the data was approached and analysed in the chapters that follow.

## Hypotheses and research questions

As it was made clear in the chapter on literature review, the research findings so far suggest that small and fragmented agricultural markets are conducive for development of agricultural cooperatives which, apart from correcting the market failures, also perform social and farmer-specific economic roles (Bonus, 1986; Staatz, 1987; Valentinov, 2005, 2007). The reality of BiH agricultural and cooperative sector lay out quite a different scenario. Instead of having a vibrant cooperative sector, cooperatives in BiH are often found at the outskirts of developments in agricultural market and at the margins of development agendas.

Tainted by the socialist legacy, cooperatives find it difficult to reorganize so that they appeal directly to the needs of farmers in an unstable institutional environment. Such a situation suggests that there are barriers to cooperative development both inside their structures as well as outside of them in their immediate institutional environment. This evident paradox represents the essence of the research problem.

To better understand the nature of these barriers, as well as the potential of the cooperative organizational form to serve as rural development tool I ask several research questions: What are the key problems faced by agricultural cooperatives in BiH? What types of cooperative enterprises populate Bosnia's agricultural market? Do they follow internationally recognized cooperative principles in conducting their business both with members and non-members? Do currently present policy instruments enable or constrain the development of cooperative enterprises? What are the basic internal and external barriers to cooperatives being more viable instrument of rural development in BiH? What factors halt their transformation into more productive enterprises?

There are two general hypotheses explored in this research:

- a) Functionality of cooperatives as instrument of rural development depends on the existence of a set of institutionally enabling factors that reduce system uncertainties and allow the model to reach its development potential;
- b) The scale at which agricultural cooperatives positively impact the livelihoods of farmers depends on how cooperative internalizes its 'cooperativeness'.

These generalist hypotheses are then broken down to a number of more specific ones. Based on the existing theoretical inferences on the suitability of cooperative model to agricultural setting, its internal dynamics, and its interaction with wider institutional environment I propose relationships among a number of variables presented in the following hypotheses.

In Chapter IV that looks into evolutionary path of the cooperative idea on the territory of former Yugoslavia, specifically focusing on the period of socialist regime, I hypothesize that frequent changes in institutional environment and overall inconsistency of values decrease the ability of cooperative members to fully comprehend the purpose of cooperative enterprise. This in turn limits their ability to identify with the mission of the enterprise.

In Chapter V where I discuss the legal framework within which cooperatives operate in present day BiH I argue that lack of clarity in legal environment, defective and highly divided governance structures, and evident societal divide all negatively affect the position of cooperatives in the market and give rise to degenerated forms of cooperatives.

Chapter VI presents the empirical analysis of 210 agricultural cooperatives in BiH. It looks into a number of context specific organizational and institutional variables that affect the performance of agricultural cooperatives in BiH. Several relationships are hypothesized in this chapter. Firstly, it is proposed that participatory governance structure is assumed to have a positive effect on cooperative performance. Secondly, presence of social property in a cooperative is assumed to have a negative impact on cooperative performance. And thirdly, cooperatives that rely more on their non members than on members for productive activities tend to have better economic performance measured by income per member or nonmember derived from doing business with the cooperative.

In Chapter VII, which deals with the relationship between the assignment of property rights and development of cooperatives, I hypothesize that unclear property rights in cooperative sector have negative effect on allocation of resources and specifically on long term investment decisions in cooperatives.

Chapter VIII looks into issues of incentives for collaboration among cooperatives, their mutual trust, and existing social capital as factors useful in determining their propensity to engage in collaborative work. It treats trust and social capital as essentially productive factors in

cooperative enterprises and hypothesizes that the absence of clear economic incentives coupled with low levels of institutionalized and interpersonal trust tend to preclude cooperation among cooperatives.

## Conclusion

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The objective of this chapter was to highlight the methodological dilemmas associated with an attempt to define and measure cooperative success with the degree of consistency that would warrant arriving at some generalized insights on functioning of cooperatives. To that end, it started off by classifying presently available empirical studies on cooperative performance into several categories, namely those that use financial ratios to estimate financial health and viability of cooperative model and those that rely on various measures of efficiency. In most of the scholarly contributions in both of these literature strands, cooperatives are compared to IOFs in the same industry. While such comparisons may always reveal something new about both these governance structures, relying fully on such approaches is rather limiting as it reduces the complexity of the cooperative model to only one dimension that can be comparable to the IOFs. Nevertheless, in situations in which social aspect of cooperatives is not that apparent or is for other reasons difficult to understand one can resort to measuring at least the economic aspect of the cooperative enterprise hoping that it uncovers reasons for those cooperatives' focus on economic benefits alone.

Recognizing the multidimensional nature of cooperatives as well as their embeddedness in the local context, this research will benefit from using both qualitative and quantitative methodologies in its assessment of the development potential of cooperative model. The chapter then presents two general and a number of specific hypotheses that are explored in this research.

In a gist, using data from multiple sources, this thesis argues that agricultural cooperatives can be engines of rural development when there is a basic alignment between the institutional environment and the ability of cooperatives to respond positively to its signals by internalizing their cooperative identity both in their governance structures and in their dealings with non-members.

# Chapter IV

## The history of cooperative movement in BiH: From state sponsored to state obstructed idea

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Mind being a scarce resource, cognitive specialization has economizing consequences.

Oliver F. Williamson (2000)

### Introduction

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The first two chapters of the thesis highlighted the contextual issues that surround agricultural cooperatives in BiH and main scholarly contributions in the analysis of institutions, organizations and their mutual interaction. Drawing on Williamson's (2000) view on levels of social analysis, it is evident that the study of organizations in North's sense or institutional arrangements in Williamson's cannot disregard the embeddedness of organizational forms in their wider institutional context. Various elements of the institutional environment either directly or indirectly shape the internal structure of organizations thus affecting their behaviour even if the channels through which this happens are not always clear or susceptible to generalizations. Therefore, values, norms, rules and laws become increasingly important in understanding the organizational variety that characterizes today's economic systems.

Having in mind that changes in informal institutional environment happen rather slowly, the importance of values and norms is even more pronounced in those countries that had endured sudden and violent shifts from one political ideology and economic system to another. Exploring one such context, this chapter follows the evolution of cooperative idea within the institutional environment of former Yugoslavia by highlighting the political, economic and policy milestones in the history of the cooperative movement. The time span covered in this chapter ranges from early 1900s when Yugoslavia was a monarchy, moving on to its socialist period from 1940s and ending with its final break-up in the early 1990s. The values and norms that were at the base of each of these periods are believed to be fundamental in understanding the current state of cooperative movement in BiH.

By reviewing the evolution of institutions during the period under study, the chapter elaborates on norms and values that evolved and affected the evolution of the cooperative idea in former Yugoslavia and BiH and that have sustained their influence over the cooperative sector in the region through a number of path dependence mechanisms. Therefore, the chapter

hypothesizes that frequent and rapid changes in institutional environment undermine the ability of cooperatives as governance structures to respond and adjust effectively to changing market conditions. To that end, several research questions are explored in this chapter: What kind of path dependency mechanisms support the survival of old values and norms despite major changes in the institutional environment? Are any of these mechanisms specific to transitional countries? What values and norms in cooperative sector were generated through Yugoslav kind of socialism? What was the aim of many agrarian reforms implemented during the socialist regime in former Yugoslavia? What was their effect on the cooperative sector in BiH? What values and norms enshrined in cooperative laws prior to the break-up of Yugoslavia managed to survive the collapse of the regime itself? How the persistence of old values and norms affects the adaptability of cooperative enterprises? Were cooperatives developing alongside institutional changes, because of them, or despite of them? How was their identity shaped by frequent institutional turbulences? These questions will be tackled through the sections that follow.

## Path dependency and structural change: mapping the challenges in an institutionally turbulent context

The scholarly literature produced by agricultural economists and development experts in the last half of the twentieth century and in the recent years reveals that the agricultural sector has particularly interesting responses to structural changes in its immediate social, political and economic environment, showing surprisingly rigid organizational forms (Horvat 1971; Stipetic 1982; Sexton 1990; Hind 1997; Binswanger and Deininger 1997; Mathijs and Swinnen 1998; Happe 2004; Rozelle and Swinnen 2004; Addison 2005, Gramzow 2009). Naturally, the speed at which this sector detects internal and external changes and responds to them varies among countries and across different economic systems (Rozelle and Swinnen 2004). Nevertheless, the lack of adaptability of organizational forms within the agricultural sector appears to be one of the major obstacles towards capitalizing the market opportunities in agricultural and food industries.

As economic analysis has moved from simply dissecting the conceptual representations of firms and other organizational types present in the market towards more of an organizational introspection as suggested by Coase (1992), it became only logical to marry certain aspects of agricultural economics to those of the new institutional economics. This can be attempted within the larger framework of structural change where the intersection of these two fields helps explain the failure of a number of top-down attempts to direct the pace of structural change through ill-conceived policy instruments that hardly match the needs of targeted organizations.



Once the institutional change becomes imminent and the structural change in a specific sector starts to follow its natural progression, the incongruence between policy instruments and organizational needs may prove to be an additional challenge towards successful intra-organizational restructuring. Agricultural sector of BiH and more specifically its agricultural cooperatives, as it will be shown in the chapters that follow, are quite illustrative of this dynamics.

The share of agriculture in the economy of most post-socialist countries, the dual composition of the sector consisting of many small semi-subsistence farms and a few large ones, low levels of modernization across the sector all contribute to structural change being either slowed down or misdirected in many of these countries (Möllers et al., 2011). Actually, the slowness and misdirection of structural change in agriculture applies more to former Yugoslavian countries than it does to other post-socialist European countries. One way to explain this is to look into the nature of transition processes in different European regions that had experienced socialist regimes in the second half of the twentieth century. While progression from socialism to democracy was more linear in central European countries, in the former Yugoslavia it was disrupted by violent conflicts that resulted in destroyed physical and social infrastructure. The prospects of the EU membership for post-socialist central European countries certainly speeded up structural changes and reforms in many sectors, agriculture included. The same cannot be said for former Yugoslav republics for which the EU accession process has been rather protracted further slowing down important structural reforms.

Given the differences in the pace of structural change in different countries it is helpful to think of structural change as a dynamic process that evolves in constant interaction with the surrounding factors of economic, political, social and cultural nature (Happe, 2004). Structural change in agricultural sector primarily refers to how organizational forms already present in the sector change their production habits, including the structure of production, in order to capitalize on the newly created market opportunities (Buchenrieder, 2007).

As dynamics of structural change processes varies across sectors and organizational forms, one can observe different levels of adaptive capacity in organizations ranging from highly inflexible ones to somewhat more dynamic vertically integrated up- and downstream enterprises. Given that structural change agents interact with their environment it is understandable that their flexibility or lack thereof cannot simply be ascribed to their internal features. The policy environment as well creates a framework in which organizations either evolve naturally towards the most cost-effective way of functioning owing to proper policy incentives or, due to a mismatch between policy goals and organizational needs, persist despite their inefficiency and lack of flexibility (Goddard et al., 1993).

However, despite sometimes unfavourable policy environment almost all organizational forms exhibit some capacity to learn, to adopt new behaviour and adapt to a changing environment. It is the pace of change that sets efficient organizations apart from the inefficient ones. In some situations, post-socialist and post-conflict context being one example, when markets are underdeveloped and institutional environment is generally uncertain, the retreat to old values and learned ways is more common than seeking to pick up the speed of structural change towards adopting new efficiency-enhancing organizational features. Under such circumstances, the process of deconstructing the knowledge and more importantly the habits of 'the old ways' may appear to be more challenging than acquiring new and innovative frameworks of functioning. Strong ties with the past make it hard for old organizational forms to capitalize on their expertise in a particular sector once the institutional frame has changed. In this way, tacit sector-specific knowledge stays locked-in in rigid organizational structures unresponsive to external pressures. Understanding the process of structural change in contexts of deeply intertwined formal and informal, old and new institutional forces is the conundrum that juxtaposes the strength of path dependency mechanisms against the natural inclination of organizations to mimic the behaviour and habits of their more efficient counterparts as suggested by DiMaggio and Powel (1991).

Therefore, in understanding the reach of old values and norms it is important to study the path dependency mechanisms. The focus of the literature on path dependence has increasingly become the lock-in condition of path dependent processes. The extensive literature trying to conceptualize its defining features as well as some measurement mechanisms, has come up with at least three different kinds of lock-in scenarios, namely technological lock in (Nelson and Winter, 1982; Arthur, 1989; David, 1985; 1994), institutional (North, 1990; Hodgson, 2001), and spatial lock in (Krugman, 1991).

Of particular importance for this research is the condition of institutional lock-in, and for that reason I use the path dependency argument to account for persistency of institutions at the macro level as suggested by Vergne and Durand (2010). In some transitional settings, the institutional lock-in seems to have been deeply felt in terms of influencing the conditions of other kinds of lock-ins. This is especially important to a number of post-socialist countries which show limited adaptability to external changes (Pejovich, 2002). Acknowledging that economic behaviour is value-laden, Griffin (1997) argues that one's behavior in the present is a reflection of one's past values and cultural beliefs but at the same time, it affects the values that one will hold close in the future. In essence, the debate on the ability of path dependency mechanisms to reinforce a particular institutional set-up boils down to the debate on the probability of instigating fundamental institutional change.

Despite the frequent usage of the 'path dependency' construct there is still no unified view in the literature as to whether this construct denotes the process through which present institutions self-reinforce or the outcome as evidenced through a number of so called lock-in conditions, or both. As noted by Vergne and Durand (2010), there are three different levels at which the construct has been used to denote the importance of historical processes in explaining the current institutional and organizational landscape. Scholars of institutions tend to explore the path dependency at the macro level and to them, it accounts for the long term institutional persistence (Djelic and Quack, 2007; Morgan and Kubo, 2005; North, 1990). At the meso level, path dependency is used to explain governance structure inefficiencies (Gedajlovic et al., 2004; Williamson, 1999). And lastly, at the micro level, scholars refer to path dependence as equivalent of organizational rigidity (Verne and Durand, 2010).

What is paradoxical about the path dependency arguments is that some are framed in a way that suggests that behavioural choices of organizational forms that are successful under a particular institutional set up tend to reinforce those institutional structures while others suggest that path dependency need not be solely about keeping the old values but may as well include 'recombining previous knowledge' and creating something new (Kogut and Zander, 1992 in Vergne and Durand, 2010:738).

For example, Schneiberg (2007) shows that historical prevalence of a certain institutional matrix does not exclude the existence of alternative institutional paths. He substantiates his argument by presenting evidence on existence and thriving success of cooperative forms in utilities and agriculture in the US that developed alongside dominant capitalist institutional matrix. The main argument Schneiberg puts forward to explain for such parallel existence of institutional set ups is that there are certain resources within the dominant institutional structure that not only allow for organizational variety but help revive and redeploy 'alternative logics within national capitalism' (2007:47).

The following sections will briefly describe the competing institutional matrices in Yugoslavia from early twentieth century until its final break up at the end of it. By following the logics of then prevalent institutional structures, the chapter will map out the evolution of the cooperative movement specifying the values and norms that underpinned its survival despite major changes in its institutional environment.

## Yugoslavian institutional matrices from early 20<sup>th</sup> century until its dissolution

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This section will review the emergence of different institutional matrices on the territory of now former Yugoslavia. The period covered in this chapter encompasses the pre-socialist Yugoslavia and socialist Yugoslavia until its break up in the 1990s. It coincides with the emergence of first cooperative enterprises on Yugoslavian territory.

From the period of its parliamentary monarchy in the early 1920s until its final dissolution in early 1990s, Yugoslavia's political and economic systems had gone through a number of significant alterations. Such economic and political fluctuations have left the mark on the current development of its successor republics, albeit in different degrees and magnitude. A cursory glance at the internal dynamic processes that shaped the Yugoslav-style capitalism, put in place the contours of its specific type of socialism and finally gave birth to democratic aspirations of its republics all reveal the workings of the mechanisms that helped sustain a bond between the Yugoslav past and its republics' present.

### Inter-war period and the first agrarian reform

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The Old Yugoslavia, established in 1918, or the Kingdom of Yugoslavia as it was known from 1929, comprised geographical regions that showed strikingly different levels of economic and socio-political development. Taking roots in this newly formed country, capitalism was much widely accepted in the northern parts of the country formerly ruled by the Austro-Hungarian Empire, while the southern parts of Yugoslavia, namely Serbia, Macedonia, BiH, and Montenegro, were somewhat resilient to the forces of capitalism and were consequently less developed at the time (Randelović, 1990). Although the country itself lagged behind the rest of Europe in terms of industrialization, agricultural production on small family farms was the backbone of rural economy and an important source of livelihood for its rural population. Randelović (1990) further notes that during that time agriculture participated with 50% in the country's GDP, while in 1932 agricultural exports constituted some 50.6% of the overall Yugoslavian exports.

Although family farm was the main unit of agricultural production, cooperative organizational form was not at all alien to this system. In fact, it was an effective form of domestic organizing in the face of huge inflows of foreign capital (Simonović, 1991). However, despite the important contribution of agriculture to the country's GDP, state structures did not pay much attention to agricultural sector and technological advancements of its production processes. This was evidenced through a number of agrarian reforms which, as it turned out, were more of political than economic nature, but had both political and economic consequences. Agrarian reforms in this context refer primarily to changes in ownership structure of the

agricultural resources, primarily land, that had the effect of systemic and institutional nature and had profound and longlasting consequences on the institutional environment and organizational forms through which agricultural activities were carried out in affected countries.

The first agrarian reform that would leave significant marks on the structure of agricultural sector and system of land ownership in BiH covered the period from 1919 to 1933 when BiH society as a whole “experienced deep transformations” (Bougarel, 2012:313). The reform was both extensive and at times aggressive. Propagated as an attempt to restructure agriculture of the country by replacing the feudalism with private land ownership granted to peasants, the reform drew its legitimacy from the proposition that small holders’ farms are more efficient than large holdings (Živkov, 1976). The fact that Serbia participated in the First World War (WWI) on the side of the Allies that emerged as winners in 1918 affected greatly the nature and results of the first agrarian reform.

That the matter of agrarian reform was given a primacy over other issues in the newly formed Kingdom of Yugoslavia was evident from the fact that the Ministry of Agrarian Reform was set up in 1919 with a sole purpose of overseeing the implementation of the reform. This Ministry ceased to exist ten years later in 1929 by which time most of the reform's provisions were already implemented. Ministry of agriculture took over the jurisdiction related to the reform until the beginning of the Second World War on the territories of the Kingdom of Yugoslavia in 1941 (Malović, 2006).

Almost immediately after the end of the WWI, newly formed state issued a number of decrees and announcements which later became the reform programme and which set out to do the following: abolish all forms of serfdom between the peasants who worked the land and owners of the land especially on the territories of BiH, Macedonia, parts of Montenegro, Kosovo and region of Metohija; those who worked the land (serfs)<sup>21</sup> were to become free peasants and would be given the ownership over the land they worked; previous owners (begs and agas)<sup>22</sup> were to be paid off immediately or by installments; all big land holdings were to be subjected to the reform (Živkov, 1976: 26-37).

At the time, BiH was a part of the Kingdom of Serbs, Croats and Slovenes (KSHS)<sup>23</sup> that existed between the two World Wars and covered territories of at the time provisional State of Slovenes, Croats and Serbs, independent Kingdom of Serbia together with Kingdom of

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<sup>21</sup> The local word used to describe the peasants who became owners of the land is 'kmet' (kmetovi, plural) and is not entirely equivalent to the meaning of the word 'serf'. Although 'kmetovi' were to an extent owned by their patron they were under his protection from invaders and foreigners and were entitled for a remuneration for the work (usually in kind) that was either consumed by them or sold in the market.

<sup>22</sup> Beg and aga (singular) are nobelty titles given by the Ottomans to wealthy heads of families, usually of Islamic faith. There are certain scholarly allegations that the first agrarian reform was discriminatory as it was aimed at expropriating privately owned parcels of land from previous nobility, known as 'begluci' or private property of begs (Imamović et al., 1993). However, there are also authors who treat the subject more cautiously and do not reduce it simply to an antagonistic relationship between serbian serfs and muslim land owners but look at the reform through political and economic dimensions (Kamberović, 2003).

<sup>23</sup> Colloquially known as the Kingdom of Yugoslavia, and officially renamed that in 1929.

Montenegro and regions of Kosovo, Vojvodina and parts of Macedonia. Following the announcement made by the Regent Alexander on the need to implement the agrarian reform in 1919, the Decree on Liquidation of Agrarian Relations<sup>24</sup> was passed in Old Yugoslavia and was to be implemented in all of its territories except in Serbia (Efendić-Semiz, 1996). Since the announcements of the upcoming agrarian reform resulted in much social tension between peasants and land owners, trying to mitigate the pressures the Regent himself declared that „the land will only belong to God and peasants“ (Erić, 1958:53). This, however, served a limited purpose as much of the land was actually appropriated through violent means.

At the outset, the reform had been recognized as a controversial issue inasmuch as it targeted directly large land owners from one ethnic group impoverishing them by expropriating their large land parcels and giving them away to peasants who previously worked the land. Additionally, it was geographically limited to only some parts of the country. Many land owners whose land was expropriated migrated out of BiH leaving their land in the hands of new owners, former peasants. This way, the reform affected not only the resource ownership structure but also demographics of many parts of BiH. Consequently and contrary to optimistic estimates of the reform advocates, the productivity levels in agriculture dropped significantly as the structure of resource ownership was forever altered (Kamberović, 2003).

There was a political side to the reform worthwhile considering. Since Ottoman Empire ruled the region for approximately five hundred years, the social structure of land ownership it left behind as a legacy reflected the religious composition of BiH at the time of the Ottoman rule. In other words, the land owners in BiH were predominantly local Muslims (Bosniaks) and those who worked the land belonged to other, less privileged religious groups at the time like Orthodox Christians. The Austria-Hungarian Empire that replaced the Ottoman regime left this agrarian structure in tact. According to the latest census carried out during the Austria-Hungarian rule in BiH in 1910, around 91.1% of all land was owned by Bosniaks (Muslims), while Orthodox Christians (Serbs) owned around 6%, Catholics (Croats) owned 2.6% and others owned 0.3% of all land in BiH (Efendić-Semiz, 1996). This clearly reflects the structure of land ownership in BiH prior to founding the KSHS.

When the KSHS was established, the Bosniaks (Muslims) lost the ‘privileged’ status they held during the Ottoman rule and were reduced to a religious minority with no political or cultural autonomy (Efendić-Semiz, 1996). The agrarian reform of the inter-war period was aimed to establish a completely new system of ownership rights, thus affecting the political relations in the BiH society. The manner of the reform presumed an almost complete shift in ownership rights whereby most of the land, and particularly large land holdings, were taken from Muslim begs and agas (landowners) and given to peasants who worked them at a symbolic price, which

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<sup>24</sup> Official Ghazette of the Kingdom of Serbs, Croats and Slovenes 111/1921

in many instances was not even paid for (Efendić-Semiz, 1996). This led to previous land owners' economic decline which, in such circumstances, translated into decline of political power of Bosniaks in BiH.<sup>25</sup> Some authors called this and other agrarian reforms the "Economic Genocide against Bosnian Muslims" (Imamović et al., 1993; Tanović, 1995). Others, on the other hand, taught this to be an exaggeration and focused exclusively on studying the effects of newly emerging ownership structures (Kamberović, 2003).

Whatever the motivations behind the agrarian reform from the early 1920s, the consequences of this enormous undertaking reveal that in the aftermath of the reform and at the outset of destructive Second World War (WWII), the Yugoslavian, and by implication Bosnian, agriculture was characterized by low levels of production per worker, low levels of income, lack of development aid directed towards agriculture, immature market for agricultural produce, and highly unmotivated farmers (Randelović, 1989).

The following section describes the beginnings of the cooperative movement on the territory of the former Yugoslavia and places it in the context of the first agrarian reform.

### *Cooperatives during the first agrarian reform*

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First agricultural cooperatives appeared on the territory of Old Yugoslavia much before the first agrarian reform. Some twelve years after the first Roschdale cooperative was established, the first Yugoslav cooperative was formed in Ljubljana, Slovenia in 1856. It was followed by the first cooperative in Serbia in 1874 (Vučković, 1957).

However, no massive cooperative movement took roots until early 1900s with first *Main Cooperative Association of Yugoslavia* formed in 1919 coinciding with the beginning of the first agrarian reform. The numbers of cooperatives and members at that time were quite impressive and indicative of an important movement in making. In 1919 the Main Cooperative Association of Yugoslavia was comprised of 11.309 cooperatives and around 1.5 million members which amounted to almost 10% of total population at the time (Vučković, 1957: 81).

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<sup>25</sup>Husnija Kamberović, one of leading historians in BiH, gives an interesting reflection on the matter of agrarian reform in the KSHS and its effects on the power balances in BiH. In his essay titled „Turks and Serfs: The Myth about Owners of Bosnian Land“, part of a larger publication called „Historical Myths of the Balkans“, he points out the dangers of a trend of politization of history as a science in the Balkans and difficulty with which historians are faced when trying to entangle the truth from its fabrication. For him, the agrarian reform of the early 1920s served as an instrument for proving the immemorial presence of Serbs on the territories of today's BiH. The myth that was prevalent among the Serb population was the one that demonized the Turks blaming them for taking away the serbian land in the 15th century. Therefore, the land that was taken away from muslim land lords was acutally Serbs' land by right and 'immemorial existance'. On the other hand, Muslims had their own myths for proving their own immemorial existance. In an attempt to discredit the agrarian reform that threatened to leave them landless they claimed their right to the land by putting forward arguments of their pre-Ottoman noble origin arguing that that their right to the land stems from previous 'Bogumile' times when there existed a Bosnian church (a type of religion) and that they were named begs and agas only after they embraced Islam as a new faith. The two myths clashed both conceptually and physically in violent attempts of some Serbs to expropriate the land from Muslims. Trying to be critical of the agrarian reform, Kamberović cautiously states that given the enormity of migrations that had occurred at the time, it would be next to impossible to prove who can claim the right to Bosnian land. It is, however, a historical fact that the reform of the 1920s disturbed social and power structure of BiH society and started long and painful process of agricultural fragmentation.

For more details on this and related issues see, Kamberović, H. (2003), „Turci' i 'Kmetovi':Mit o vlasnicima bosanske zemlje, available at [http://www.iis.unsa.ba/izdavacka\\_djelatnost/posebna\\_izdanja/mitovi/mitovi\\_kamberovic.html](http://www.iis.unsa.ba/izdavacka_djelatnost/posebna_izdanja/mitovi/mitovi_kamberovic.html).

It was precisely this massive membership accumulation over a short span of time that captured the attention of state structures which started to perceive cooperatives as a political instrument in building stronger ties with rural dwellers. At first, state structures sought to control rural population through cooperative associations but it was not until 1937 that the relationship between the state and cooperatives was formalized in a form of the first Law on cooperatives ever enacted in Yugoslavia (Živkov, 1976). Until this Law became an official framework for cooperative functioning, a number of special decrees and instructions<sup>26</sup> filled the institutional void and attempted to regulate the field. However, the vast territory of the then Yugoslavia and the diversity of cooperative forms, as well as specific political goals sought after through cooperative as a political tool necessitated the unification of the cooperative sector. This formal, legislative unification came in the form of the 1937 Law on cooperatives.

The 1937 Law was an interesting document that attempted for the first time to define cooperative as “an association of unlimited number of members, with varying number of membership shares each member can acquire, in which every member participates equally and through common running of business following the principle of mutual assistance among members is primarily focused on enhancing the economic well-being of its members” (Živkov: 1976: 126). The Law did not refer to agricultural and farmers’ cooperatives exclusively. In fact, it was quite vague in defining the kinds of activities that can be pursued by a cooperative. Instead, it focused on clarifying organizational details of cooperatives, establishing basic principles for their work and regulating the minimum number of persons required to set up a cooperative.<sup>27</sup> To some authors the vagueness was a deliberate act of state institutions that sought to leave more maneuvering space for themselves to influence the work of cooperatives through a variety of activities instead of just being limited to agriculture.

Parallel to passing the Law, many financial institutions were set up with the aim of aiding the work of cooperatives. The most important one was the Agricultural Bank which provided much needed capital to cooperatives. With the 1937 Law, the minister of agriculture personally got the right to supervise the work of cooperatives (Mataga, 2005). Additionally, the state lottery had to give 10% of its annual profits to special fund set up to aid development of cooperative movement (Živkov, 1976). Furthermore, the Law required that each cooperative establishes a reserve fund in which one fifth of its annual surplus should be allocated. Cooperatives were

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<sup>26</sup> Decrees and information documents that were passed in the absence of law on cooperatives were merely technical in nature and were aimed at easing the functioning of cooperatives, especially their access to capital. Among the most significant ones were the Decrees and Information from 1920 announcing that cooperatives may take no interest long term loans to capitalize their operations and Instruction on formation of agrarian associations, i.e. cooperatives. Some of them went that far as to suggest the amount of membership fee. For details see Vučković, M. (1966), *Istorija zadružnog pokreta u Jugoslaviji 1918-1941*, IDN:Beograd.

<sup>27</sup> According to the 1937 Law, there was a minimum of 10 persons required to form a cooperative. There was no lengthy and complicating administrative procedures required but instead, all that was needed is a simple request signed by at least ten persons who were then considered the founding members. This had implications in the fact that the law required the founding members to be the guarantors of the cooperative work. In other words, if cooperative faces debts in its dealings those are to be financed from the private property of the founding members.



allowed to trade with non members as well but were not allowed to sell the products purchased from them unless they process them.<sup>28</sup>

Although it was lacking clarity in its many articles, the 1937 Law was a welcome clarification of the sector's reach and potential. State structures went at great lengths to provide as much institutional assistance to cooperative organizations as possible, oftentimes in exchange for political support from cooperatives. Despite their admirable success in providing their members with various services and benefits, cooperatives that pioneered the cooperative movement in Yugoslavia were criticized for being 'member-centric' and focused only on pursuing their members' interests, while their engagement with the rest of the society went only as far as it benefited their members. Such introvert oriented behavior of cooperatives was justified by their 'capitalistic nature' (Živkov, 1976:128-129).

Cooperatives were thus perceived as capitalistic organizations set out to pursue their members' interests only. The change of the political and economic systems that followed after the end of the WWII, and especially sweeping institutional and political changes that surfaced after the demise of Yugoslavia would change this perception and attach a different value attribute to cooperative enterprises. The break-up of Yugoslavia into several independent states would mark the beginning of an open market economy that perceives of cooperatives as socialist heritage. The next section follows the dynamics that led up to this view.

## The evolution of the Yugoslav model of socialism

The previous section established that the first agrarian reform in the inter-war period was aimed at restructuring ownership of the land and strengthening the private rights over land by creating a lot of small farms. The Second World War interrupted these reformative processes and brought about a lot of human and infrastructural losses to Yugoslavian territories. In the Cold War terminology, after the WWII Yugoslavia became an important part of the communist block in Europe. But not long after introducing one-party dictatorship and central planning, in 1948 Yugoslavia parted ways with Soviet Union and not only "shattered irretrievably the monolithic image of Communism" (Unkovski-Korica, 2014: 108), but offered an alternative system to the Soviet communism through its famous self-management economic model. By putting 'the worker', or later the 'working people', at the center of its economic system Yugoslavian leadership at the time designed "a decision-making structure that is neither a compromise nor a mixture of Western-type and Soviet-type industrial relations" (Broekmeyer, 1977: 431).

Politically, several events aligned at the time that allowed Tito to introduce the new type of socialism. First, when Tito's split with Stalin became official in 1948 at the Communist

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<sup>28</sup> For example, many dairy cooperatives were allowed to buy milk from non members but had to process it into cheese before they were allowed to sell it in the market.

Information Bureau (Cominform) meeting in Romania, Tito was no longer obligated to pursue the central planning policies directed from the USSR. Although the official split happened in 1948 when the Cominform discussed the resolution entitled 'The Situation in the Yugoslav Communist Party'<sup>29</sup>, the split itself was not sudden as argued by Petranović (1981) but was a culmination of a number of disagreements over the ideological issues underpinning socialism. However, some still argue that the split was in fact the result of Stalis's growing impatience with Tito's territorial ambitions in the Balkans and lack of willingness to succumb to Soviet control (Perović, 2007).

Secondly, as Tito parted ways with Stalin, he started to play a fundamental role in creating and leading the Nonaligned Movement which had both political and economic benefits for Yugoslavia and Tito as its leader. Politically, he gained an important status as a different type of socialist statesman. Economically, Yugoslavia established important trade links with countries of the Nonaligned Movement thus strengthening its own economy and opening itself up for international trade (Torlak et al., 2011).

However, prior to the official introduction of the self-management system in Yugoslavia a number of experimental reforms were carried out in the agricultural system that in a way reversed the results of the inter-war agrarian reform. Unlike the inter-war reforms whose implementation covered a span of more than twenty years, the agrarian reform initiated in 1945 was sharp and quickly executed. A number of restrictive measures were in place as early as 1950 and mainly targeted private property.

In this way, much of the implications of the inter-war reforms were undone in a sense that private property became limited but unlike during the inter-war reforms when ownership over land went from land owners to peasants, the period from 1945 to 1950 saw the introduction of a new land owner, the state. Consequently, the structure of agriculture that emerged as a result of the post WWII reforms constituted of many small private farms and few large state owned farms (Gnjatović et al., 2012).

The basis for the reform was the *Federal Law on agrarian reform and colonization* of August 1945 which stipulated the right of the state to confiscate the land from private owners, both farmers and non-farmers with no obligation to compensate for the confiscated land. A threshold was established on the size of land plot that was allowed to be held in private property and was

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<sup>29</sup> The following excerpts from the Resolution specify some of the officially stated reasons for the split: "The Yugoslav leaders are pursuing an incorrect policy in the countryside by ignoring the class differentiation in the countryside and by regarding the individual peasantry as a single entity, contrary to the Marxist-Leninist doctrine of classes and class struggle, contrary to the well-known Lenin thesis that small individual farming gives birth to capitalism and the bourgeoisie continually, daily, hourly, spontaneously and on a mass scale. Concerning the leading role of the working class, the leaders of the Yugoslav Communist Party, by affirming that the peasantry is the 'most stable foundation of the Yugoslav state' are departing from the Marxist-Leninist path and are taking the path of a populist, Kulak party. Lenin taught that the proletariat as the 'only class in contemporary society which is revolutionary to the end . . . must be the leader in the struggle of the entire people for a thorough democratic transformation, in the struggle of all working people and the exploited against the oppressors and exploiters! The Yugoslav leaders are violating this thesis of Marxism-Leninism." Available at: <http://www.fordham.edu/halsall/mod/1948cominform-yugo1.html>.

different for farmers and non-farmers. According to the Law, non farmers could have no more than three hectares of land in private ownership. For agricultural producers, on the other hand, any surplus property above 25 hectares of arable land and surplus above 45 hectares of land in total was expropriated and placed in a state fund of agricultural land. By the time all reform measures had been implemented, the fund had around 1,611,867 hectares of land in its possession, of which 407,037 hectares were distributed among 263,000 poor families who desired to be agriculturally active but lacked resources. The rest of the fund was mainly used to create large state farms (Gnjatović et al., 2012).<sup>30</sup>

While the 1945 reform partially implied distribution of land to poor peasants who wanted to start agricultural production, in the later stages of the reform, more precisely from 1953 onwards, new restrictions on the amount of land allowed in private property were imposed. In March of 1953 a new *Law on farmland in social property and land allocation to agricultural organizations*<sup>31</sup> was to regulate land distribution and ownership rights in the country. The law limited private property to not more than 10 hectares (Simonović, 1990). Underpinning principle upon which the whole reform programme of the Communist party was built can be summarized in the following manner: 'only those who work on the land can own the land' (Maticka, 1992:290).

Another important innovation marked this period. What was previously known as state farms and state agricultural fund became social farms and social agricultural fund. Thus, the construct of 'social property' entered the legal framework and economic reality of then Yugoslavia. Implementation of the 1953 law, and further limitation on the private property in land led to the social fund being enriched by additional 275.900 hectares of arable land that was confiscated from 66 459 households (Gnjatović et al., 2012). The land that was held in the social fund was given for permanent use to organizations that were considered to be of social importance, such as cooperatives. It was this type of 'social land' that was transferred and used by cooperatives that created a host of legal issues following the breakup of Yugoslavia and introduction of the capitalist market economy that rests on the public vs private dichotomy of property ownership. These issues will be discussed in greater details in chapters six and seven.

As a repercussion of these swift and quickly introduced reforms, a crucial right to private ownership of land as the most important productive resource in agriculture was derogated to the point that very little economic strength was placed in hands of individual producers. It is in this period in particular that agricultural cooperatives somehow assumed a set of negative

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<sup>30</sup> Since many regions of Yugoslavia had a peculiar demographic and land ownership structure, and were burdened by a host of unresolved property rights from the inter-war period, a long list of laws was enacted that treated specifically the regions in question. So, there appeared *Law on liquidation of agrarian reform executed until April 6th, 1941 on large estates in Autonomous Province of Vojvodina*; *Law on the revision of land allocation to colonists and agrarian interested persons in Peoples Republic of Macedonia and Autonomous Kosovo and Metohija Region* of August 3rd, 1945; *Law on the treatment of abandoned land of colonists in the Autonomous Kosovo and Metohija Region of 1947* (Gnjatović et al, 2012).

<sup>31</sup> Official Gazette of FPRY 22/1953, 10/1965.

connotations, being primarily associated with the lack of land ownership rights, and were perceived as an organizational form that was forced upon the rural dwellers and was not a matter of their choice. The perception held of cooperatives as capitalistic enterprises that exist to benefit its members started to be modified into the perception of cooperatives as political instruments.

The move towards self-management that started to happen in the 1950s and more intensively in the 1960s brought about yet another series of shocks on agriculture. Not used to the notion of market directed production even in its limited form, many organizational forms in agricultural sector simply faded away from the economic scene due to their inability to exhibit organizational flexibility in the face of new changes coming from the economic environment (Selak et al., 2002). When central planning was replaced with social planning, already highly fragmented market for agricultural production finally faced a complete loss of confidence in its own productive capacities. Coupled with inability to provide flexible organizational forms, the lack of confidence in own productive capacities will prove to be one of detrimental factors that will limit the ability of farmers in the Yugoslavian successor states to engage innovatively with newly created market conditions and will linger in their psyche as an invisible but strong obstacle to the reform of cooperative sector.

The workers' self-management was the backbone of the Yugoslav-style socialism. It was backed up with concepts such as 'association of labor' and operationally carried out through workers' councils in an attempt to form "a decentralised, market socialism that purported to represent a participatory, and thereby more democratic, alternative to the seemingly monopolistic and bureaucratic arrangements prevailing in the East and West" (Unkovski-Korica, 2014: 109). The main idea behind the self-management system was to provide the workers with control over their labour and working conditions. In theory, the state was to be excluded from controlling the operation of enterprises. However, in practice, as it was evidenced in many studies, state or rather party, was an important actor in economic activities and despite the benefits of theoretical model of self-management, the reality painted a different picture where state kept the control over economy by covering the losses and engaging in investment policies of firms (Estrin and Uvalic, 2008).

However, and in spite of many practical problems with implementing the theoretical idea of self-managed enterprises, Broekmeyer (1977) argues that the system itself had a number of positive repercussions for the overall industrialisation pace in Yugoslavia allowing the process itself to run smoother than in other socialist countries. Additionally, Broekmeyer argues that self-management system assured graduality in the development of many important market institutions.

Along the same lines, some authors argue that the whole socialist experience in Yugoslavia needs to be viewed through the gradualist introduction of market mechanisms and can be analysed in three distinct phases. The first phase covers the initial period from 1952 to 1964. The second one starts in 1965 and ends in 1975 marking perhaps the most successful period in self-management practice. And the last one goes from 1976 until 1989 during which the dissolution process slowly begun. (Đapo, 2006)

Throughout these three periods, Yugoslavian self-management system went from 'parametric planning' to 'market socialism' to finally end with 'negotiating mechanism' system. In practice, this meant that the system itself gradually introduced some elements of competition between enterprises but still kept the power to oversee the working of the economy as a whole.

The shift from state ownership to social ownership for Yugoslavian agriculture meant further strengthening of large, industrial social complexes at the expense of cooperatives and privately owned farms. Petak et al. (2003: 238) argue that this period, which was characterized by complete focus on socially run farms and industrial production, contributed not only to a decrease in agricultural productivity but to creation of a dual society: urban-industrial with material and value support from state structures and rural-agricultural which was increasingly oppressed. During the 1960s the state went so far as to pass laws and regulations that would abolish Cooperative Associations, cooperative banks and move considerable value of cooperative processing plants and equipment to socially owned industrial complexes (Tratnik et al., 2007).

### *BiH cooperatives during socialism*

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For as long as it was a part of Yugoslavia, BiH belonged to a group of its less developed republics. The reasons behind its persistently low levels of economic development would require an interdisciplinary inquiry into the country's long history of foreign rule as well as its own internal tensions that shaped both its value system and its institutions. In order to understand the current structure, performance and role of cooperative sector in BiH, it is important to view it in relation to the wider processes of economic and political change to which all countries of former Yugoslavia were subjected but also to look into its own internal evolution of cooperative idea.

First BiH cooperative was formed in 1904 near the small town of Orašje. This, like many other cooperatives that were formed during this period was credit cooperative.<sup>32</sup> First agricultural cooperative in BiH was established in 1909 (Šoljić et al., 2005). Despite many political and economic disturbances, the number of cooperatives in BiH grew steadily and by

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<sup>32</sup> There is a clear influence of the Reiffeisen type of rural credit cooperative on early credit cooperatives in BiH.

1927 there were even four cooperative associations established in BiH (Selak et al., 2002).<sup>33</sup> Božić (1960) notes that in the circumstances of general socio-economic conditions in the Old Yugoslavia and BiH cooperative sector of BiH developed rather well with number of agricultural cooperatives rising from some 200 in 1913 to around 350 in 1939. The period from 1945 onwards ushered BiH cooperative sector into a completely new socio-economic system that had its own evolutionary phases burdened with many difficulties and social experiments. Like cooperatives in other Yugoslavian countries, BiH cooperatives were subjected to the stressful and damaging processes of social and economic change practiced through forced collectivization and later inclusion of cooperatives into social sector.

According to Selak et al. (2002), the development of cooperative sector in BiH can be observed through three distinct periods:

- a) From the establishment of first cooperatives around 1904 until the end of WWII in 1945;
- b) From the introduction of socialism until first democratic elections in 1990;
- c) From the 1990s war and until present period.

During each of these periods as agrarian reforms were progressing cooperative enterprise acquired a different ideological label that often contradicted the mainstream institutional matrix in place. This resulted in the one-way dynamics that ran from institutional environment to cooperative enterprise in an attempt to mold it and make it fit into the larger purpose of the system itself with little regard to cooperative principles and identity. Without a supportive institutional structure, and with little clarity as to the cooperative purpose, it is no surprise that cooperatives witnessed a general decline in numbers, membership and importance from one period to another as it will be shown in the discussion that follows.

Throughout the short history of BiH cooperative movement, its farmers had been forced to adjust their productive activities to constantly changing economic circumstances. The price paid for the frequent disturbances of social and economic conditions was the absence of a definite and established model of organizing agricultural production. Much like in other former Yugoslavian countries, there were periods in the history of BiH when cooperatives served to protect the economic interests of its members. However, much longer and more deeply felt were the times when cooperatives were used as state instruments for exerting control over farmers' output and income. Because of the influence of the 1940s, 1950s and 1960s the cooperative form of organizing was not seen as an end in itself, but rather as an organizational form that deviated almost completely from cooperative values and principles. Under the pressure from the state structures, cooperatives in BiH were forced to change their character, content, orientation as well as their internal and external relations with strategic partners.

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<sup>33</sup> Cooperative associations that existed at the time to an extent reflected ethnic composition of the BiH society. Therefore, in 1927 there were Serb, Croat, Bosniak and German Cooperative Associations.

Compared to other republics of former Yugoslavia, BiH proved to be especially vulnerable to frequent fluctuations in agricultural policies and reforms due to its heavy and widespread dependency of its rural population on agricultural activities. Prior to World War II, BiH's agricultural sector was almost devoid of capital and in absolute lack of resources necessary for technological advancement of production and market placement (Selak et al., 2002). In an extremely poor condition, this sector was subjected to socialist philosophy of collectivization, which left long lasting repercussions on the structure of cooperative sector and cooperatives' attitudes towards both process and product innovativeness.

Of particular gravity was the influence of the 1946 Law on agricultural reform which forcibly created peasant-worker cooperative, as an organizational form that further discredited the right of farmers to use their land freely and to freely form organizations that would advance their economic and social interest (Božić, 1959). The aim of these socialist inventions in agricultural sector was to aid the process of collectivization and re-education of farmers so that their production corresponds to the expectations of the socialist government. They were modeled after the Soviet style kolhoses, and were tasked with transforming privately owned resources into collectively owned ones.

The peasant-worker cooperatives were all agricultural producer cooperatives based on collective ownership of production facilities as well as collective work efforts of its members. This form of cooperatives completely demolished the right of farmers to privately own land; in some instances the ownership of private houses was regulated by the rules of the cooperative. Farmers, largely disappointed by coercively enforced system of collectivization, were not motivated to contribute to this organizational form resulting in extremely low production levels. When forced into peasant-worker cooperatives, farmers were given the choice to either bring in their private land (except for the backyard land) and treat it as rented land therefore charging a fee or to give in their land without charging anything. Either way, peasants were discouraged to join cooperatives as they were not able to freely use their resources.

The attempts at collectivization of agriculture through the forcible set up of peasant worker cooperatives subsided in power during 1952 and 1953 when the number of these cooperatives dropped significantly. For example, in 1952 there were around 6.973 general agricultural cooperatives in Yugoslavia (61.9% of all cooperatives) while the peasant worker cooperatives made up around 37.5% of all cooperatives. The rest were specialized cooperatives. In the same year, there were around 686 peasant worker cooperatives in BiH, 732 general agricultural cooperatives and no specialized cooperatives in BiH.<sup>34</sup>

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<sup>34</sup> Official Ghazette of Federal Peoples Republic of Yugoslavia 1954.

This led to the dissolution of this organizational form as soon as the political climate was favorable. A period from 1950 to 1952 evidenced a very sharp decrease in numbers of this cooperative kind in BiH from 1.505 in 1950 to 686 in 1952 (Selak et al., 2002).

Table 5 Number of cooperatives in BiH in the 1950s

Description	Year		
	1957	1958	1959
<b>Number of cooperatives</b>	658	632	588
<b>Number of members (in ths)</b>	296	237	264
<b>Number of workers</b>	6.196	6.369	7.274
<b>Number of office workers</b>	2.436	2.759	2.980
<b>Number of agricultural experts</b>	321	352	459
<b>Number of farms</b>	361	432	438
<b>Land in ha</b>	4.160	5.006	3.751

Source: Šoljić et al., 2005: 42.

The period of the 1950s was very significant inasmuch as it put a ceiling to the amount of land allowed as private property thus further cementing the process of land market fragmentation whose consequences are still widely felt in BiH agricultural sector. Because of this, agricultural market of BiH is still characterized by extremely small privately owned land parcels.

Psychological consequences of high dependence on state determining the price of products and market assessment techniques for agricultural cooperatives are still visible and particularly so in the attitudes of farmers towards production. An overall sense of confusion in terms of role that cooperatives should play for their members and their immediate community can certainly be ascribed to the previous regime's oscillations in terms of prioritizing between different economic sectors regarding their role in overall economic development of the country. These oscillations went as far as to completely abolish some forms of cooperatives (mainly credit cooperatives and some specialized agricultural cooperatives) where it was believed that there was a space for state-owned firms to take the lead in economic development. Furthermore, the right to democratic votes in cooperatives was abolished as well (Selak et al., 2002).

In addition to reversing the previous development of cooperative sector, the policy instruments from the 1960s onward did nothing to enhance the capacity of cooperatives and individual farmers to adapt to changes in institutional and market environments. By completely derogating the basic values of cooperatives there was little incentive for people to form them and participate in their work. The effects of the laws and regulations passed in the 1960s are evident from the numbers of cooperatives that existed in the early 1960s and a decade later. Selak et al. (2002:78) inform us that in 1961 there were 3.228 cooperatives in Yugoslavia (329



in BiH; 929 in Croatia; 140 in Slovenia). Some thirteen years later, in 1974 there left only 813 cooperatives in Yugoslavia (49, 89, 44 in BiH, Croatia and Slovenia respectively). It is clear that the decreasing trend in number of cooperatives meant that they were either shutting down or what really took place in most instances was that cooperatives were increasingly turned into small worker managed businesses whereby they lost most of their cooperative identity. They would remain to function like this until the dissolution of Yugoslavia in the 1990s. In an attempt to strengthen agricultural sector in their own way, communist party promoted integration of primary producers in agriculture thus creating many agricultural-industrial complexes that were the favored form of business organization in former Yugoslavia.

When Yugoslav republics became independent states, many of these ill-developed organizational forms faced unforeseen challenges when faced with fully open market economy system. Information presented by the Federal Association of Cooperatives in Bosnia and Herzegovina show that although there is an increase in number of cooperatives in the Federation of Bosnia and Herzegovina, the dominant kind (92% of all cooperative kinds in agriculture) are the general cooperatives, with very little attention paid to setting up specialized cooperatives. Specialized cooperatives would require very specific knowledge and skills, perhaps niche resources and the cost of setting up something that has rarely been tried on the territory of BiH was simply never attempted by local farmers, nor supported by public institutions. Needless to say, BiH cooperative sector today does not look much different from the cooperative sector of BiH when it was one of Yugoslavian republics.

Some of the most dominant problems voiced out by the Association of Cooperatives BiH are the following: (a) unresolved issue of cooperative asset ownership; (b) negative experiences with agricultural cooperatives in the socialist regime; (c) lack of laws and regulations as pertaining to the sector; (d) the necessity to have a stronger state level association of cooperatives (Selak et al., 2002). Although the law on cooperatives was passed in 2003, not much changed in the content of these overarching problems. The inability to break the linkage with the Yugoslav conception of agricultural sector remains the stumbling block towards innovation in agricultural organizational forms.

It is still not clear whether cooperative form as presently practiced among the farmers in BiH truly gives an opportunity to capitalize on potentials in agricultural production. While there is some space to argue that overall political fragmentation of the country weighs heavily on its poor economic performance, following solely this political argument would be a scapegoat for many things that could be done concerning the structural changes within the agricultural sector itself. Poor and rather complex institutions, inadequate administrative capacity of state structures, farmers cut off from the market, high levels of rural poverty, inefficient organizational structures within the cooperative sector itself all contribute to fuelling the

perception of cooperatives as obsolete relics from the past. If they were to be judged by the ICA cooperative principles, most cooperatives in BiH today would probably not even qualify as cooperatives. According to available data, prior to the 1992 war there were around 196 agricultural cooperatives in BiH. Out of that number, some 72 functioned in the territory of what is now known as Federation of BiH and the remaining 124 in the territory of today's Republika Srpska (Šoljić et al, 2005: 415). Cooperatives in BiH have been subjected to frequent and often shocking changes in their institutional environment which is exemplified through a long list of laws that regulated the sector from the times when first cooperatives were set up in Kingdom of Yugoslavia until today.<sup>35</sup>

In the aftermath of the 1990s war, much attention and capacity in BiH had been devoted to procedural reforms (enacting new laws, releasing opinions favoring entrepreneurial activities, setting up new organizations, strengthening NGO sector), while little attention has been paid to substantial intra-sectoral reforms that could revive productive capacities of certain industries. This is understandable to an extent. BiH was a newly independent state that needed its institutional structure to be in place before any meaningful, long term reforms were to ensue. When it was one of the Yugoslav republics, BiH had a very dense concentration of successful military and car-assembly industries which lost their regional and international markets due to the 1990s war atrocities, while the domestic demand was hard to recover in a setting of a complete institutional breakdown. The catching up in these highly technically demanding industries has been judged too costly. Nevertheless, most of the post-war donor aid that came to the country went into rehabilitating these industries, which in 1998 resulted in industrial recovery being located primarily in sectors such as electricity, coal mining, and power transmission.

However, it has been almost systematically forgotten that apart from being an industrial country, Bosnia and Herzegovina was still reliant on agriculture for the well-being of its rural population. As a consequence of these post-war recoveries being directed mainly towards reviving sectors other than agriculture, the reform of agriculture has taken much longer than anticipated.

The final disarray of Yugoslavia in the early 1990s left its six republics to battle with the underpinning values of the old system while searching for much needed flexibility in organizational forms and institutional architecture conducive to development of agricultural sector in market based economy. The success rate at which countries of former Yugoslavia seem to have been able to constructively internalize capitalistic features of their new markets seems

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<sup>35</sup> The Commercial Law from 1883; The Law on Business Cooperatives 1937; The Law on Cooperatives 1946 and the Law on Agricultural Cooperatives 1949; The Law on Agricultural Land Fund and Distribution of Land to Agricultural Organizations 1953; Decree on Agricultural Cooperatives 1954; General Law on Agricultural Cooperatives 1965; The Law on Association of Farmers 1973 and 1978; The Law on Agricultural Cooperatives 1989; The Law on Cooperatives FBiH 1997; The Law on Agricultural Cooperatives Republika Srpska 1999; General Law on Cooperatives BiH 2003.

to correspond to the patterns that existed in the Old Yugoslavia, singling out Bosnia and Herzegovina as one of the poorest regional performers in this regard.

## Conclusion

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The multitude of agricultural policies and reforms that characterized pre-socialist and socialist years all seemed to have showed an alarming degree of incongruity, all aiming to achieve mass production in agriculture through collectivization of resources. Admittedly, agricultural sector did receive more attention in the country's development strategy, however the modes through which state institutions planned the use of resources and development of agricultural sector in the end resulted in a limited capacity of farmers to innovate and technologically improve their production. All of this point to the fact that the attention paid to agriculture was merely nominal and very state-centric.

Furthermore, in the context of constant policy flux and pressure from the reforms in which farmers found themselves, it was neither possible to nurture any particular form of agricultural organization nor viable to develop workable and functional cooperative models that can survive all policy changing shocks that came in the abundance during the socialist Yugoslavia.

In their study of the Balkan entrepreneurs, Liargovas and Chionis (2002) empirically establish that the most significant barriers to transition from central planning to market economy are by far the values and attitudes of entrepreneurs (40% of the total), followed by the business environment and lack of appropriate skills, 25% and 35% respectively. Persistence of similar institutions over time and in spite of turbulent political and economic changes has slowed down the structural reform in agriculture and sustained the image of cooperatives as inefficient enterprises that serve politics more than they do their members and communities.

When the process of institutional change, as a longitudinal phenomenon, is viewed in the framework of repetitive attempts of ex-Yugoslavian governments to create more flexible socialist institutions, it has to be recognized that the process itself was a discontinuous one (Kyriazis and Zouboulakis 2005). Taken together the agricultural reforms left a particularly painful imprint on then Yugoslavia's agricultural cooperatives from which they never fully recovered and hardly ever will without a new systemic approach that allows them to pursue their true nature – that of helping farmers achieve higher levels of productivity and general well-being.

# Chapter V

## Formal institutional environment of BiH cooperative sector: supporting or stifling cooperative development?

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Institutions play a key role in the cost of production.  
(Douglass C. North, 1990)

### Introduction

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This Chapter highlights the importance of the formal institutional environment in creating a supportive framework for development of cooperatives. Formal institutional environment as used in this chapter comprises of laws, bylaws and any kind of official government legislation either directly (general or specific laws on cooperatives) or indirectly (taxation, competition or general organization law) related to functioning of cooperative sector. By using the ILO (2012) recommended guidelines for legislating cooperative laws, this chapter assesses to what extent the BiH law on cooperatives and associated laws conform to these recommendations both formally and substantially.

As of recently, there has been a very broad and widespread recognition of the importance of supportive institutional environment for development of cooperatives. The gradual identification of cooperatives as development tools has ultimately led to the UN designating 2012 as the International Year of Cooperatives with the slogan: “Cooperative enterprises build a better world”. The formal support to cooperative development by international organizations can be traced back to 2001 when the United Nations General Assembly issued a list of guidelines on creating a supportive environment for the development of cooperatives. This document especially underlines governments’ views of cooperatives “as associations and enterprises through which citizens can effectively improve their lives while also contributing to the economic, social, cultural, and political advancement of their community and nation” (UN Guidelines, 2001:3). Furthermore, the document recognizes the specificity of a cooperative form of business seeking from the governments to establish institutional environment and policy context in which cooperatives would not be discriminated against on the grounds of their

peculiarities and which could serve as a backdrop against which cooperative form could actually fulfill its economic and social potential.<sup>36</sup>

International Labor Organization reiterated these claims and further emphasized that cooperatives, being participatory enterprises, have the potential to contribute to job creation and job stability, meaningful mobilization of resources, and ultimately to foster solidarity as an important aspect of socio-economic development. The ILO Recommendation 193 (2002) is clear on the role of government in creating a supportive policy environment and legal framework that in no way restricts the nature of cooperative enterprises. Interestingly enough, the Recommendation is itself a source of international public law (Henry, 2013; Fici, 2013).

The debate on the role of the government in fostering cooperative development has taken somewhat controversial turn with some authors arguing that no economic development miracles ever took place without well thought-through government policies to enable development efforts (Bateman et al., 2011). Preferably, the public interventionism should come from local governments so as to ensure that the mix of development instruments corresponds well to the local context. Such a model has been named a 'local development state' (Bateman et al., 2011).

An underlying and common premise to these international and localised efforts is an important one: development of cooperatives and local self-help enterprises is as much a reflection of their institutional and policy context as it is of their internal organizational features. In addition to legislative documents and policies indirectly related to cooperatives such as taxation, competition or general organization laws, to name a few, cooperative specific legislation is the most visible expression of the formal institutional and policy context. Although it is difficult to generalize anything on the topic of cooperative legislation given the specificities of each country, there have been several attempts in the literature to deduce the most important practices in cooperative legislation worldwide and to point to the role played by legislation in encouraging or stifling development of cooperative enterprises (Münkner, 2002; 2012; Hanry, 2012).

In line with these views, I hypothesize that the lack of clarity in legal environment, defective and divided state governance structures, and evident societal divide all negatively affect the position of cooperatives in the market and lead to the creation of degenerate forms of

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<sup>36</sup> The document itself is surprisingly clear when it comes to recognizing the specific kind of developmental contribution that can be sought through cooperative enterprises highlighting that it can only be obtained if and when institutional and policy contexts recognize the special features of these enterprises. A succinct synthesis of governments' replies to the survey questionnaire administered by the Economic and Social Council on behalf of the UN General Assembly, this document offers a list of concrete steps governments had taken to ensure that cooperatives are on equal footing with other kinds of governance structures in their respective industries. The Guidelines offer a useful list of general recommendations that could certainly contribute to clarifying some of the most common misconceptions about cooperative enterprises internationally. Document available at: <http://www.un.org/documents/ecosoc/docs/2001/e2001-68.pdf>

cooperative enterprises or cooperative enterprises that are registered as agricultural cooperatives but are in fact multistakeholder cooperatives.

Several research questions guide the analysis presented in this chapter, namely: what kind of policy instruments currently exist in BiH cooperative sector? How is the matter of cooperative development treated in these legal documents? Is BiH a unified legal space when it comes to formalization of cooperative enterprises? Is the currently valid state level law in agreement with the ILO recommendations for cooperative legislation? What kind of state interventionism could foster development of cooperatives in BiH given the political context of this country? Do cracks in the existing legal edifice allow the flourishing of the so called 'family cooperatives'? These questions are treated in sections that follow.

## Of cooperatives, for cooperatives and by cooperatives: an overview of dominant legislative practices

At the outset it must be noted that cooperative legislation is primarily a reflection of every country's specific historical experience including the evolutionary path of its cooperative sector. At the same time, it is equally an expression of its present political structure. As such, each attempt to legislate for and in cooperative sector is bound to be restricted to country-specific challenges and power structure relations. Therefore, it must be analyzed keeping these boundaries in mind.

Regardless of the internal differences present among many different organizational forms rooted either in their distinctive values or divergent understanding of enterprises' purpose, one thing remains in common to all forms of governance and that is the external institutional environment in which they are formed and in which they function. At times, this is not adequately represented in their efficiency equations but instead the effects of institutional environment on organizational efficiency are often taken for granted. As recalled in Munkner (2012), the 1977 ICA report is suggestive of the importance of external conditions under which cooperatives function. It states the following:

"The fundamental idea of human beings working in concert in pursuit of common aims is basic to civilized society. The cooperative form of organization is the most rational socio-economic instrument ever devised by man to do certain things under certain conditions, but it does not perform well under quite different conditions, and perhaps not at all in pursuit of goals that are alien to its nature and true purpose."  
(ICA, 1977:88)

Henry (2012) argues that the reason to legislate for cooperatives throughout history has gone from the need to differentiate them from conventional firms in legal sense to using legislation to approximate the cooperative form to its for-profit counterparts in the market. The first phase dates back to the mid-19<sup>th</sup> century while the latter phase is of a more recent origin, starting from 1970s onwards. Essentially and in the broadest sense possible, it appears as though cooperative legislation went from tendency to diversify cooperative legal form from other types of enterprises to isomorphic tendencies of assimilating them to the prevalent organizational form which, under certain circumstances, threatened the very substance of cooperative character.

Enacting legislation for cooperatives matters not least because it enhances legal clarity but also because it helps identify crucial characteristics of cooperative enterprises that show that cooperatives are born not only out of necessity but also out of preference. In other words, it lays the ground for creating a more supportive environment for development of cooperatives.

Additionally, legislation provides the basic guidelines for further design of policy making instruments whose quality may very well depend on the clarity of a cooperative legislative piece. It needs to be taken into account that legislation often has political pretenses attached to it, and especially in politically fragile settings, and may through overly regulating a cooperative form aim to use it to further ideological purposes as was sometimes the case in countries that practiced the strict forms of communism (Munkner, 1998).

There are different traditions across the world when it comes to legislating for cooperatives. Some countries opt not to have a separate law on cooperatives, like Denmark, in which case the functioning of their cooperatives is governed by a set of other general laws. On the other hand, some countries opt for enacting specialized laws on specific kinds of cooperatives like agricultural, credit, marketing, housing etc. At times, these laws can get so detailed that they leave very little for cooperative members themselves to decide in which case such legislation can be perceived to be too interventionist. However, majority of cooperative legislation is situated somewhere in between these two extremes with countries regulating cooperative sector through a single, general law on cooperatives leaving the specifics of their internal organization to cooperative boards and assemblies to decide upon.

In analysing cooperative legislation, Fici (2013) adopts a framework that revolves around three major themes which, he argues, should form the backbone of any cooperative legislation, namely: the cooperative objectives, cooperative financial structure and cooperative governance. Under-regulation of any of these three pillars and subsequent treatment of under-regulated organizational kind under the law that is legislated for a different kind of enterprise may endanger the very nature of the enterprise in question (Fici, 2013).

In order to understand the full scope of influence that legislative framework has over development of cooperatives one needs to also recognize that laws and regulations constitute only a part of what can be termed a cooperative wider environment. The final effect of laws is but a reflection of the dynamics between legislative framework and other parts of that environment that are to be found in relevant sociological, economic, political and even cultural features of the country itself. Laws are significant inasmuch as they help regulate these other parts of cooperative environment through setting the basic benchmarks for what constitutes a cooperative friendly environment. In the view of Münkner (2002:8), a supportive environment consists of “free access to markets, capital, general support services, training programmes, information, public tenders, and allows vertical and horizontal integration and networking at all levels, exempting user-owned and user-controlled enterprises from restrictions of the competition law.” An important aspect of that environment is in fact the existence of cooperative capacity among members themselves, and it is in relation to that factor that the success of legal framework in aiding the development of cooperatives should be appraised.

The ILO Guidelines on Cooperative Legislation (2012) provide a basic blueprint of components that every reasonably acceptable law on cooperatives should have, treating twelve different sections of the law from preamble and general provisions to relations of cooperatives to third parties. More specifically, these essential steps read and summarize in the following table.

Table 6 Main elements of a cooperative law

The main contents of a cooperative law	Description
<b>Preamble</b>	The purpose is to guide the interpretation of the law; especially important in contexts where cooperatives are not solid structures; should contain short explanation on the role of cooperatives, their character and nature, their relation to the government, and should establish equal treatment of cooperatives and their members with other existing legal forms.
<b>General provisions</b>	Clear definition of terms used in a law; providing reference to other laws that are applicable to cooperative enterprises; clearly spelling out the definition of cooperative reflecting whether the law is of general or specialized kind and taking into account federated structures as well and not just primary cooperatives (where applicable); spelling out basic cooperative principles.
<b>Formation and registration</b>	Registration authorities, types, costs, procedures clearly specifying documents necessary for registration.
<b>Membership</b>	Spelling out any restrictions on membership like membership of legal person, restrictions concerning age; minimum (and/or maximum) number of members; admission criteria and procedure; resignation from membership; exclusion and suspension; obligations and rights of members;
<b>Organs/bodies and management</b>	Principles of functioning and members’ participation; Composition of the general assembly and powers of different bodies; Bylaws and status information; Decision-making procedures; Composition and functioning of the Board of Directors.



<b>Capital formation, accounts, surplus distribution and loss coverage</b>	Financial resources (internal and external); Defining a minimum share capital; Legal reserve fund; Setting up daughter companies owned by a cooperative; Transactions with non-members; Surplus distribution; Reimbursement of capital.
<b>Audit</b>	Who audits cooperatives, how often and on the basis of which documents and data.
<b>Dissolution</b>	Law should spell out the steps for dissolution.
<b>Simplified cooperative structures</b>	Law should spell out conditions under which it allows certain informal cooperative groupings to evolve into cooperatives. In certain cases, such groupings, if allowed, need not establish all of the governing and management bodies usually required for autonomous cooperatives.
<b>Horizontal and vertical integration</b>	Law should define the legal form of different levels of integration together with their activities and including their rights and obligations.
<b>Dispute settlement</b>	Law should provide guidance on a dispute between members, members and cooperative bodies, or inter-cooperative dispute.
<b>Miscellaneous</b>	Any other issue of interest to a particular state

Source: Hagen Henry (2012), ILO Guidelines for Cooperative Legislation.

Using the above listed structure as recommended by the ILO, the following section will first outline the existing policy instruments that directly or indirectly treat functioning of cooperatives. After that, the 2003 General law on cooperatives in BiH is studied against the above provided guidelines. The discrepancies that exist between this law and other cooperative specific legislation in BiH are accounted for.

## Post 1995 policy environment in BiH

As it was established in the previous chapter, throughout the history of its cooperative movement, a number of laws and official documents regulated cooperative sector of BiH. It was not uncommon for these laws to be in contradiction with one another. In the post 1995, i.e. post-war period, several legal documents appeared aiming to regulate the sector and these too reflected administrative divisions in the country. For example, in 1997 the Federation of BiH, one of two administrative entities in BiH, enacted the General Law on cooperatives<sup>37</sup> that gave the freedom to cantonal governments to pass more specific laws on various kinds of cooperatives. In Republika Srpska, on the other hand, the first Law on agricultural cooperatives was passed two years later, in 1999<sup>38</sup> but in its content was merely a reflection of the 1989 version of the similar law adopted in then Republic of BiH.

<sup>37</sup> Official Ghazette of FBIH 28/97. Available at <http://www.fbihvlada.gov.ba/bosanski/zakoni/1997/zakoni/o%20zadr%20%28hr%29.html>. Interestingly, this Law was very silent on the status of cooperative property. In fact, it stipulated that issues related to unresolved property need to be treated through a separate law. This Law did not guarantee the existance of indivisible cooperative property but instead viewed cooperative property as a simple sum of individual members' property.

<sup>38</sup> Official Ghazette of RS 18/99.

The General Law on Cooperatives in BiH, hereafter the General Law, adopted in 2003<sup>39</sup> was the first state level law enacted in the post-1995 period aimed at regulating cooperative sector across the country. The General Law is aimed to no specific kind of cooperatives and lower levels of government are free to enact a more specific legislation which Republika Srpska did in 2008 when it passed a Law on agricultural cooperatives. However, some of its provisions are in direct conflict with provisions of the General Law on cooperatives.

Brčko District has its own Law on cooperatives which is also in contradiction with some of the General Law's articles. Effectively, three different cooperative specific laws govern a very small geographical space of BiH and its rather modest cooperative sector.

In addition to these three laws which directly regulate the cooperative sector there are a number of other legal documents which indirectly regulate the work of agricultural cooperatives. Among the most significant ones is the Law on value added tax in BiH which applies to cooperatives too. No specific tax exemptions are provided for cooperatives and they too must comply with the tax regulation that applies to all firms in the market.

When it comes to specific support measures, it is difficult to isolate any development programme targeting specifically cooperatives either on entity or municipality level. There is no financial support to agriculture as a sector from state level institutions due to specific jurisdiction vested in the Ministry of foreign trade and economic relations BiH which is tasked only with coordinating activities of the lower level ministries.

Entity level ministries of agriculture, as well as some municipalities, have their own budgets aimed at development of agriculture. However, most of the policy measures are very general in nature and do not target cooperatives specifically except in one aspect. Federal ministry of agriculture does provide financial support to efforts aimed at creating producer groups or association of farmers (not specifically cooperatives) but the support given to such efforts is very marginal. According to the strategic document published by the Federal ministry of agriculture, less than 1% of budget for agriculture is devoted to these efforts. Additionally, cooperative associations can apply and get funded for specific projects but the maximum amount of support is 5 000 euros, which is insignificant compared to the needs of these associations.

Although agricultural cooperatives have been given more institutional attention in Republika Srpska in the recent years<sup>40</sup>, they represent only around 2% of all agricultural producers in this entity. According to the data of the Ministry of agriculture in RS, around 30% of all registered cooperatives are active, while others have no economic activity and are usually

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<sup>39</sup> Official Ghazette of BiH 18/03, passed on 01.07.2003.

<sup>40</sup> In 2011, Ministry of agriculture in RS has produced the Programme for development of agricultural cooperatives in RS from 2011-2016, which gives a useful analysis of cooperative sector in RS together with envisaged development trajectories.

burdened by problems related to unresolved property rights. Financial support to agricultural cooperatives in RS does not differ much from that in FBiH.

Since cooperatives in BiH receive no special treatment under any law, this chapter will further proceed with the analysis of the General Law on Cooperatives in BiH and will look into how this law compares with the ILO recommendations on legislating for cooperatives. The General Law on Cooperatives in BiH has altogether 98 articles. The following is its assessment using the ILO recommendations for cooperative legislation. Where appropriate, differences between the three existing laws in BiH as well as associated challenges for cooperatives will be highlighted.

## Preamble

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Although recommended by the ILO Guidelines as an important guidance for law interpretation and especially relevant to those countries where cooperatives are yet to reach their true nature, the General Law contains neither preamble nor further interpretations of the law. This Law never received an official interpretation regardless of the fact that some of its provisions created quite a stir in relations between cooperatives and local governments.<sup>41</sup>

## General provisions

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The General Law does not provide the glossary of the key terms and concepts used in the document except for the definition of a cooperative contained in the Article 1, which reads:

“Cooperative is an organizational form comprised of voluntarily joined individuals (members) who then, through joint ownership and democratically controlled enterprise, achieve their common economic, social, and cultural needs”.

The Law does spell out five cooperative principles in its Article 2 which reflect a somewhat condensed version of the seven ICA principles and they are as follows:

- a) Voluntary and open membership;
- b) Democratic control of business by coop members;
- c) Participation of members in the division of benefits and coverage of losses;
- d) Business independence and free flow of information among members;
- e) Cooperation among cooperatives and care for common ownership.

The ICA principle pertaining education and training is not provided in this list.

## Formation and Registration

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An entire section in the General Law is devoted to rules related to formation and registration of cooperatives. The Law proscribes that a minimum of five natural or legal persons can start a

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<sup>41</sup> Interview with an employee of the Cooperative Association of BiH, July 2013. The relations with local governance bodies were mainly disturbed because of issues pertaining to the ownership over cooperative property.

cooperative but is silent about the minimum of capital necessary to start a cooperative – this is left to cooperatives to decide through their internal documents. A cooperative may be registered even if has no full or part time employees. Generally, this section provides enough detailed information regarding the setting up process of a cooperative.

However, the Law on agricultural cooperatives in RS is in contradiction to the General Law regarding the nature of persons who may set up a cooperative – in RS, the law clearly states that only natural persons can create a cooperative. The law on agricultural cooperatives in Brcko District sets a minimum of seven natural persons for cooperative to be formed. Additionally, the law on agricultural cooperatives in Brcko Districts prescribes the minimum for an initial capital at 3.000 KM.<sup>42</sup>

## Membership

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Although in earlier articles the Law allows legal persons to be members of cooperatives the section devoted to rights and obligations of members is restricted to natural persons only. The Law details that everyone has the right to apply for membership in any cooperative and the cooperative has 30 days to decide upon the application.

In its Article 7, the Law stipulates that cooperative should deal exclusively with its members when conducting economic activities except under certain circumstances when it can decide by its own internal documents to do business with non-members in which case all the net surpluses made in this way are to be reinvested in a cooperative. However, the Law fails to define the amount of transactions out of total transactions allowed with non-members. Furthermore, as regards exclusion, suspension and resignation from the membership the Law leaves these matters to be decided in the cooperative internal acts. This leaves a lot of space for irregular behaviour on part of management structures in cooperatives.

The law on agricultural cooperatives in RS stipulates that those cooperative members who happen to be employed in the cooperative could not be elected in any of its bodies. This is in a way a violation of cooperative members' equality. There is no such requirement in the General Law.

An important aspect of cooperative business that concerns what Münkner (2002) calls 'the capacity of members to cooperate' has not been dealt with properly in the existing legal documents on cooperatives in BiH. What Münkner meant by "members' capacity to cooperate" is that members actually need to own productive resources and that they themselves should already be engaged or have the capacity to be engaged in the activity that is being further promoted through the means of a cooperative. In other words, when outlining conditions for cooperatives in general, and especially agricultural cooperatives, it is necessary that the

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<sup>42</sup> KM – Konvertible Mark, local currency. The amount of 3.000 approximates around 1.500 EUR.

members themselves are farmers who own and work on the land otherwise setting up an agricultural cooperative makes very little sense.

Since these issues have not been sufficiently clear in the existing legislation in BiH, the cooperative landscape has seen a rise in numbers of the so called 'family cooperatives' in which there is only one owner of the land, usually male who is the head of the family, and the remaining four/six/nine members necessary to register a cooperative (depending on the geographical location of the coop) come from his immediate family who, together with the actual land owner, work on the land but have no resources of their own. What such members bring into the cooperative is not land but solely their labor and integrating them into cooperative structure as members equal to all other members raises a number of questions regarding the nature of the cooperative that is thus formed. Firstly, in such cases we can no longer speak of an actual agricultural cooperative although the predominant activity that is carried out within such a framework is of agricultural nature. What happens in Bosnia is that the type of cooperative is defined by the main activity it is engaged in rather than by the type of resource pool and activities carried out using the resource. A prevalence of cooperatives that are of general nature, i.e. neither fully engaged in production nor completely devoted to marketing, can also be viewed in this light.

What lack of legislative clarity in this regard creates is the ability of multistakeholder cooperatives to be registered and run as agricultural cooperatives. A series of issues pertaining the decision making processes and power relations emerge from allowing such 'cooperatives' to exist. It is very unlikely that these enterprises would engage in meaningful and participatory governance beyond mere formalities and especially in their relations with cooperants. Since they are in essence private farms registered under the cooperative name it is also highly unlikely that they will devote any of their excess revenues to investing in local community thus their social aspect beyond creating benefits that accrue to the immediate family members are virtually non-existent.

At the same time, they appear to be doing rather well economically, as they are focused merely on profit making, and are often favoured by international donors when it comes to grant distribution and participation in various development projects: as they are evaluated based on their economic performance. They often work extensively with a number of 'cooperants' or non-members who supply them with goods that they themselves have no capacity to produce. Such 'cooperatives' often have an internal structure that rests on a legal minimum number of members which is never more than ten and often collaborate with up to one hundred or even more cooperants or non-members.

While such enterprises may be economically stable their development impact boils down to generating benefits to essentially one nucleus or extended family. Not regulating this part of the

law will continue to create confusions as to the very purpose of agricultural cooperatives in Bosnia. Failing to formalize the reality of multistakeholder cooperatives which operate under the name of agricultural cooperatives further postpones an important task of reforming the part of law that refers to defining the possibility that more than one class of stakeholders and members may wish to come together in a cooperative in order to satisfy their particular need. Multistakeholder cooperatives differ from the typical cooperative which is usually owned and used by a single stakeholder category as in the cases of a producer coop owned by producers or a worker coop owned by workers, and the difference stems from the multistakeholder cooperatives' inherently more complex governance structure that balances far more diverse interests than a typical cooperative.

The analysis of currently present legal documents that regulate the cooperative sector reveals that the conditions for becoming a cooperative member are not very specific as to the actual capacity of members to cooperate. The end result is that the sector itself is populated by far more internal diversity existing among agricultural cooperatives than one could assume in the first place. Looking at the data on cooperatives in agriculture, it is rather challenging to distinguish between actual agricultural cooperatives and multistakeholder cooperatives in the agricultural sector. This is a clear indication of a policy failure to capture and regulate the diversity among the existing organizations in cooperative sector in BiH.

## Bodies and Management

As for the management of a cooperative, in its Article 29 the Law establishes the 'one member, one vote' principle. However, in the Article 30 it calls for certain flexibility with regards to this principle allowing for weighting of voting power based on the amount of business a member does through a cooperative, his role in a cooperative, or based on the amount of capital invested when he/she joined a cooperative. However, if a general assembly of a cooperative consists of more than 50 members not more than 5% out of total votes should be vested in one member alone.

According to the General Law, the main management bodies of a cooperative are: cooperative assembly, steering committee, advisory board and a director. Cooperative assembly performs majority of functions related to strategic development and operation of a cooperative such as deciding upon development and business plans, setting up of a cooperative daughter firm. Cooperative assembly is composed of all cooperative members.

However, the law allows for a possibility that a cooperative internally decides on whether its director is elected directly by members through a cooperative assembly or by some other management body of a cooperative. This also leaves space for misuse because it limits the

democratic practices in cooperatives such as choosing the management through democratically casted votes by cooperative members.

In case a cooperative has more than 300 members, general assembly is composed of their representatives who must be at least 30 in number and who must be natural persons. A steering committee must have at least three members. Cooperatives with less than 25 members do not have to have a steering committee but need to have a supervisory board. Similar to a steering committee, a supervisory board must have at least three members. However, this is not the case in the RS law on agricultural cooperatives. According to this law, if a cooperative has less than ten members there is no legal obligation to form a steering committee. The problems related to setting up governance structures become especially prominent in the so called 'family cooperatives' for reasons discussed in the previous section.

### Capital formation, accounts, surplus distribution and loss coverage

A cooperative may use capital from its members, other local and foreign natural or legal persons' capital, as well as its cooperative property and state owned property. Cooperative property, in the General Law, is defined as 'property acquired through operations and business of a cooperative or it has been acquired in some other way.' Cooperative property is indivisible. In case it is sold, the monetary gains acquired this way must be reinvested back in a cooperative.

However, in reality much of the power when it comes to dealing with cooperative property and finances has been vested in cooperative directors. This particularly refers to the rights directors exercise over cooperative property where there are certain cases of directors mishandling the property, selling it or using as a mortgage without the consent of the cooperative assembly.<sup>43</sup> This can be ascribed to lack of clear legal boundaries to what a director can or cannot do, as well as lack of knowledge on the part of cooperative members as to their rights as members.

### Audit

Audit is treated under articles that treat duties and obligations of cooperative associations making it their duty to perform regular and on a need-to-do basis auditing of their members. The General Law specifies that regular audit is to be done every two years and by certified auditors of the state level apex organization, while the Law on agricultural cooperatives in RS obliges cooperatives to have an annual audit. Furthermore, the RS law proscribes that the audit should be carried out by representatives of the entity level Ministry of agriculture which is clearly not a requirement of the General Law. On top of everything else, auditing of the cooperative apex organizations is completely unregulated by any of the existing laws which in

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<sup>43</sup> Interview with the Cooperative Association of BiH employee, July 2011.

and of itself is rather problematic given the needs for improvement in cooperative federations and apex bodies.

## Dissolution

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Dissolution of a cooperative is treated in different parts of the General Law but not under one specific section. Matters related to conditions of cooperative dissolution are left to cooperatives themselves to decide.

## Simplified cooperative structures

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There is no mention of these structures or any other form of pre-cooperative structures in the General Law. The Law deals primarily with primary cooperatives, cooperative business networks, and cooperative associations.

## Horizontal and Vertical Integration

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In General provisions of the General Law, article 5 stipulates that 'cooperative business networks' are to perform for their members what primary cooperatives perform for theirs and are to abide by the same rules that are relevant for primary cooperatives'. In essence, horizontal and vertical integration are also encouraged through listed cooperative principles in Article 2 one of which is cooperation among cooperatives.

An entire section of the General Law is devoted to cooperative associations, federated structures or apex organizations. The Law defines Cooperative Associations as 'autonomous interest based and professional business organizations set up to improve the functioning of cooperatives and protect their common interests'. One of the highlighted functions of the cooperative associations<sup>44</sup> is that they should be the voice of cooperatives when dealing with government and public institutions, and more specifically the role of the Cooperative Association of BiH is to establish collaboration with international partners and organizations, i.e. to be the voice of BiH cooperatives internationally. A cooperative association is set up by a number of cooperatives or by other cooperative associations.

However, the RS law on agricultural cooperatives in its article 65 directly violates the provisions of the General Law's articles referring to the right given to the Cooperative Association of BiH to internationally represent BiH cooperatives by granting that right to its entity level Cooperative Association which is just one of the founders of the state level Cooperative Association.

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<sup>44</sup> There are currently three cooperative apex associations: Cooperative association of FBiH, Cooperative association of RS and the umbrella association, Cooperative association of BiH formed by the former two associations. While the Cooperative Association of BiH is legally tasked with internationally representation it is provided no funding from the state to finance such an obligation proscribed by the state level law.



Although the General Law tackles the issue of cooperative business associations in its Article 5 and spells out that they perform for their members functions similar to those that primary cooperatives provide for their members, it was left unclear what is the minimum number of cooperatives necessary to establish a cooperative association. Following the definition of the cooperative business association it could be concluded that five cooperatives are necessary to establish such an association. However, law does not elucidate any further on this matter though it might have been useful given the rare existence of these associations which could perhaps be justified precisely by a lack of understand of their composition, role and management style.

## Dispute Settlement

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A number of penalty provisions is listed in Articles 85 through 87 and are mainly related to penalties for failing to comply with the present Law including the false use of the cooperative name as well as avoiding to undergo regular auditing procedures.

## Miscellaneous

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This is the last section of the General Law and it contains 11 articles most of which refer, among other things, to the types of property a cooperative may use as well as rights and duties associated with the use.

Of special interest are the articles that handle issues of property in cooperatives. In Article 88, for example, the Law says that a cooperative can use state property but has no right to use it as a mortgage. In its Article 94, the Law stipulates that ‘the property that is currently being used by cooperatives becomes cooperative property’. In Article 95, it details this and stipulates that ‘property owned by cooperatives and cooperative associations after 1<sup>st</sup> of July 1953 and which was due to some organizational restructuring and status related changes given to some other users who are not cooperatives or cooperative associations will be given back to its original users..’

The biggest and the most debated difference between the General Law on cooperatives and the RS law on agricultural cooperatives is in the latter’s treatment of the cooperative property. According to the RS law and its articles 48 and 49 any property registered as state or social property, even if a cooperative had the right to use, manage and dispose of it is now to be transferred to the local governance institutions (municipalities and cities) and can be leased to cooperatives but with no right to lease the property to third parties. The application of these two articles on part of the BiH territory has raised a number of complaints of cooperative that operate in RS but to no avail. Being in clear violation of the state level law, local authorities in RS push for the implementation of the entity level law especially with regards to property.

Finally, the Law clearly states that once it enters into force other lower level laws are null and void. In reality, as it has been shown throughout this chapter, this has not been a case further contributing to a rather unstable and insecure legal environment in BiH.

Ministry of agriculture, water management and forestry in RS (2011) reports that only 43 cooperatives function in accordance with the law, owing to the fact that compliance with one law invokes breaching another. Additional cost to agricultural cooperatives in RS derives from the fact that to protect their property, which is clearly safeguarded by articles 94 through 96 of the General Law, they have to finance usually lengthy and expensive court disputes in order to prevent their property being confiscated by local governance institutions as entity level law allows.

Although government officials in RS claim that this provision was aimed to protect social and state property from being misused by irresponsible cooperative directors, its implementation has created even more confusion in the legal environment and to the point that relations between cooperatives and their local community are under a heavy strain. As a result of this provision, many cooperatives have tried to 'legalize' the status of their property which could be deemed social and unresolved and wanted to register it at local registra, as was allowed under the General Law. Some of them managed to properly register their property as their ownership, while others despite having perfectly admissible proofs that property was legally acquired by cooperative either through purchase or members' investments, were not allowed to register their ownership over property in question. Instead, that property was registered on local community as state property and was in some cases sold to third parties, often private investors.

## Conclusion

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This chapter looked into the importance of formal institutional environment to proper functioning of cooperative enterprises. It started off by showing the growing importance international organizations have attached to creating an institutional environment that is favourable for cooperative development. The growth of research into cooperative law and legal environment also speaks of significance that is increasingly being attached to the role of institutional environment in supporting cooperative growth.

The introduction to BiH political context that is pertinent to understanding the legislative framework in place was given in Chapter I. Having established that there is one state level law on cooperatives in general, and two other laws that target agricultural cooperatives enacted at lower levels of governance, and that all three function in parallel to one another, the chapter highlighted the fragmented nature of BiH institutional space within which cooperatives function. The ILO guidelines for good cooperative laws were then used to judge the quality of BiH General Law on cooperatives and to compare to two other laws that exist in Republika Srpska and Brčko District. Several conclusions stand out from this analysis.

Clearly, the existence of three contradictory laws on cooperatives in itself destabilises the cooperative legal environment in BiH. Furthermore, since no official interpretation of the General Law exists many of its important and less clear provision are left to an ad hoc interpretation by cooperatives themselves which in turn creates a host of different views on important legal provisions.

Additionally, the General Law is very vague on a number of issues and those are usually left to be dealt with through cooperative internal documents. One problem with that is the assumption on part of the law makers that all cooperatives have the necessary capacities to enact documents that would be sufficiently clear and effective in handling the sensitive issues related to their functioning. In reality, they do not. A lot of opportunistic behaviour is permitted due to lack of clarity in legal environment.

A less publicly discussed but equally alarming matter than generality of legal documents is the fact that these are now supported by effective implementation mechanisms. As a result of legal ambiguity the cooperative sector in BiH is populated by enterprises that have nothing to do with cooperative true nature. In fact, this problem was recognized in one of the strategic documents of the Federal ministry of agriculture (2006) where they estimated that close to two thirds of cooperatives registered on the territory of FBiH do not abide by basic cooperative principles. The divergence from cooperative principles is present in how they organize governance structures, in how cooperatives deal with members and perhaps most interestingly in how they deal with non-members who are in some way associated with cooperative. Additionally, the laws do not provide enough clarity between different types of cooperatives that

may exist which leads to a number of essentially multistakeholder cooperatives to be registered and perceived as agricultural cooperatives.

Furthermore, the Law on agricultural cooperatives in RS is simply unconstitutional. It assumes state-like qualities for an administrative entity and it clearly violates a legal instrument that is by its strength above the entity level law.

Additionally, there is an alarming level of inconsistency with regards to implementation of laws in all parts of the country. This is most notably the case in RS where local governance units, i.e. municipal offices and city councils, are in some cases overly exploiting their local political power.<sup>45</sup> Perhaps more alarming is the courts' inconsistency in how this matter is handled in case-to-case basis.<sup>46</sup> And even though there is a nominal acceptance of the General Law in FBiH, there are cases there too of local municipalities forcibly confiscating cooperative property<sup>47</sup>.

Overall, complicated political and administrative structure, lack of widespread implementation of the General Law, lack of trust in legal institutions, lack of capacity in cooperatives to align their internal structures first with basic cooperative principles and then with their legal environment all contribute to cooperatives' weakening market position in BiH agricultural sector. The institutional environment in BiH is certainly less supportive than necessary for cooperatives to truly realize their productive potential. Their efficiency, as will be shown in the chapter that follows, suffers as a result of this.

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<sup>45</sup> Interview with cooperative director whose cooperative's land was confiscated and then sold to a local businessman who used it to build his private gas station, June 2011.

<sup>46</sup> Rajko Kulaga, president of the Cooperative Association of RS, speaks of this and states that: "Although law does give an opportunity to cooperatives to use the social property for their own gain, the problem with the law derives from the fact that different local courts have had a different record in applying it with some courts condoning the cooperatives' evidence of ownership over this property while other courts did not take such evidence in consideration and awarded the property in question to the local governance units to manage them as they see fit. Because of this, many cooperatives had to resort to pursuing all available legal means in order to settle the matter and this created many additional costs. Even the courts in different cities rendered different decisions some in favor and some against cooperative claims to property."

<sup>47</sup> An agricultural cooperative in a small municipality of Jablanica has had issues with local authorities who tried to confiscate some of its property in the urban parts of the city. Interview with the cooperative director, June 2011.

# Chapter VI

## Cooperative efficiency in BiH: The analysis of institutional and organizational determinants

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Investor ownership is not a logically necessary concomitant of free markets and free enterprise. Rather, it is quite contingent, a form of organization that is often but not always dominant given current technologies.  
(Henry Hansmann, *The Ownership of Enterprise*, 1996)

### Introduction

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Following the analysis of informal and formal institutional context of agricultural cooperatives in BiH presented in the previous two chapters, this Chapter focuses on explaining the main determinants of cooperative economic efficiency for a sample of 210 agricultural cooperatives. The approach taken to measuring cooperative efficiency in the BiH context rests on the assessment of two important cooperative dimensions: *cooperative objectives* and *cooperatives' patron-centered nature*. The cooperative objectives dimension reflects what cooperatives do or strive to do, while the patron-centered nature reflects their organizational and governance mechanisms that revolve around patrons and help them attain their objectives. The findings presented in the previous two chapters inform the interpretation of these two dimensions in BiH cooperative context.

As regards *cooperative objectives*, they are seen to emanate from the dual nature of cooperative enterprises (Bonus, 1986), and are thus defined as complex and multiple. Viewed in a wider social economy context, cooperatives belong to what may be termed 'socially-oriented firms' being primarily "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) or by a mix of them (multi-stakeholder cooperatives) (Borzaga, Depedri and Tortia, 2011:19).

Bonus (1986) points out that cooperative worth lies in its ability to balance what may at first appear to be two opposite forces, namely private, independent activities of farmers and joint activities of coop members. In his view, a successful cooperative is able to balance the two in order to keep the core benefits of individual and independent farming while maintaining the benefits of collective organization like risk sharing and transaction cost minimizing benefits.

Distinct ownership structure, decentralized governance style and specifically complex objectives that surpass mere economic benefits (Spear, 2000; Novkovic, 2008; Rob, Smith and Webb, 2010) is what sets cooperatives apart from other market coordination mechanisms. Their appeal as a coordination mechanism of economic activities, however, derives not only from their ability to provide economic benefits to their members but also from their capacity to provide benefits on top of the economic ones and all this in a participatory environment and in a spirit of economic democracy.

Furthermore, cooperatives are able to put their economic efficiency to a wider social use, transcending simple pecuniary interests of their members. When they are able to do this, they are proven to be instrumental in creation of social trust, a crucial element of economic development (Sabatini, Modena and Tortia, 2012) and a condition for them to project their democratic governance methods into their community.

Through their not-for-profit nature, democratic and inclusive governance structures, and care for community cooperatives seem to be well suited to providing goods and services in the cases of either private or public market failures as well as to complement various government programmes aimed at local development (Weisbrod, 2009; Borzaga and Tortia, 2012).

As regards the *patron-centered nature* of cooperatives, the literature seems to be in agreement when it comes to viewing cooperatives as members' benefit organizations. However, benefit distribution is just the end of the productive process, and it happens only if the process as a whole has been able to create new value and minimize the associated costs. The way in which the patron-centred nature of cooperatives is conceived of in this research goes beyond benefit distribution and includes considerations related to meaningful participation of members in the life of their cooperative. There are, however, situations in which the participation along different stages of production process differs in terms of who takes the predominant role, and here I am not only referring to the category of members. To differentiate between distinct 'layers' or categories of stakeholders and to better understand their mutual relationship, this chapter introduces and explains a distinction between 'beneficiaries' and 'users' in BiH cooperatives, two categories of patrons of which former refers to members and latter denotes contracted non-member suppliers with strong connection to the cooperative, i.e. cooperants. The distinction is particularly useful in understanding the dominant cooperative model in BiH in which both beneficiaries and users share in distribution benefits albeit to different degree, but only one group has a right to benefit from participation in governance mechanisms.

Given the focus of cooperatives, their attempt to balance between benefits of individual farming and collective organization, and their presence in the competitive environment suited to characteristics of conventional firms, it is understandable why it is so difficult to define and measure cooperative efficiency and success. Consequently, the choice of performance indicators

ends up depending on one's own definition of a cooperative and is conditioned by the particular aspect of the cooperative that is being studied as well as contextual limitations.

In order to explore the specific context of BiH cooperative sector, several research questions are proposed: How do we go about defining and measuring cooperative efficiency in a democracy deficient context of BiH where the notion of cooperation in agriculture is often in stark difference to the practices present in more economically advanced countries? How do the characteristics of institutional environment impact cooperative efficiency? Does the size of cooperative matter for its economic success? What type of governance mechanism produces the most optimal economic efficiency levels in terms of efficiency indicator used in this research? What is the relationship between the member-nonmember dynamics present in most BiH cooperatives and their efficiency? Does the participatory nature of cooperative enhance their economic efficiency as measured in this research? Are there any salient opportunistic forces operating within the cooperative structures in BiH agricultural cooperatives that are preventing the model to generate more visible rural development?

In light of the knowledge of BiH cooperative context, in line with previously presented findings and the quality of available data, this research opted for an individualized measure of economic success in full awareness of its limitations. Thus, the measure of economic efficiency used here reflects only economic gains of members and non-members who are involved in the functioning of cooperatives. The main objective of this chapter is to look into organizational and institutional factors that affect the level of economic efficiency in a sample of agricultural cooperatives. To that end, several hypotheses are constructed based on how literature treats the relationships between specific organizational and institutional variables and measures of efficiency. These will be presented separately for each independent variable in the remainder of the chapter.

## Understanding cooperative efficiency: the role of cooperative objectives

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In defining and understanding cooperatives it is important to distinguish what a cooperative is from what it does for its members and wider community. What a cooperative is represents its organizational identity which at the very least can be deduced from the ICA's seven principles of cooperation. What a cooperative does for its members and community is where we need to look for clues as to how to understand and then measure its performance. In other words, when thinking about cooperative performance we need to understand what members conceive to be the purpose of their cooperative and whether their behaviour matches the conceived purpose.

Additionally, there is a great diversity among cooperatives themselves rendering measurements of their performance not only difficult to capture but the conclusions derived

from such measurements almost impossible to generalize. Their internal diversity practically matches the diversity that exists between cooperatives and other organizational forms in agriculture (Le Vay, 1983). Therefore, one must be clear at the outset about the kind of cooperative enterprise that is studied minding at the same time the institutional context in which the enterprise functions.

Discussing Sosnick's framework for analysing cooperative structures, Garoyan (1983:1098) highlights the complexity of cooperative enterprise by underlying three important ways in which one may conceive of cooperatives and their efficiency:

- a) Cooperatives as horizontally integrated activities of members;
- b) Cooperatives as independent decision-making and risk-bearing organizations;
- c) Cooperatives as vertically integrated integral parts of individual farmers' operations.

All of these views are both correct and useful in understanding cooperative enterprises, as Garoyan notices. Having said that, it is noticeable that each of the three conceptions of cooperatives presented in Garoyan (1983) implies different costs to organize and run cooperative activities. On top of that, the intensity of member involvement in each of these differs as well, which in turn has a direct bearing upon the conception of cooperative performance. While the cooperative as an entity can integrate all of the three abovementioned components, measuring its performance will at the end of the day depend on the specific set of research questions, researchers' view of cooperative and a particular dimension of interest. In some contexts, the cooperative assumes only one of the above mentioned forms due to a host of cultural, political and economic factors that emanate directly from the institutional environment making the measurement of its efficiency rather context specific. But beyond the context itself, Center (1988:99) singles out several factors that are seen to affect cooperative performance in general: "overly restrictive governance, member investments in patronage refunds, negative cash flow through cooperative taxation, competition for cash payout, non-transferable assets and risks, social or economic democratic control, costs to organize, principal agent problems, and professional management."

Various performance measurements and associated dilemmas were discussed thoroughly in Chapter III. What matters for understanding the content of this Chapter and the choice of performance indicators in particular revolves around understanding the dynamics between 'what could ideally be done through a cooperative' vs 'what is realistically done given the institutional and organizational constraints'. Cooperatives as economic and social enterprises situate themselves somewhere inbetween strictly profit maximizing behavior on the one hand and disregard of profit making activities on the other. Operating in that range, cooperatives



strive to maximize their members' wellbeing which is composed both of pecuniary and nonpecuniary gains.

To be able to sustain the provision of such benefits over time, cooperatives need to achieve some level of economic stability and sustainability. In that sense, looking into pecuniary benefits is a solid indicator of how well financially a cooperative is doing. At the same time, nonpecuniary benefits are not as easy to identify and quantify as the pecuniary ones. The difficulties associated with generalizing the exact content of nonpecuniary benefits stem from their context dependent nature and their direct link to local circumstances. Thus, the safest way to understand the success of any enterprise is to turn to its stated objectives and motivations and judge its achievements in relation to those objectives (Bourne et al., 2003 in Soboh et al., 2009).

While the variety of organizational forms that populate economic systems testifies to the variety of motivations present in individual or collective actors (Borzaga, Depedri, Tortia, 2011) one also must acknowledge the role played by socio-economic and political realities in shaping individual motivations behind organizational choices.

Starting from the Maslow's theory of needs, it is clear that there exists a specific strata of needs at the individual level and that the combination of each need's satisfaction level to a large extent defines one's behaviour and therefore one's choices. Instead of assuming that every behaviour is motivated exclusively by self-interest and thus preferred due to the individualized benefits it produces, behavioural economics teaches us that actors' behaviour is at once motivated by a unique set of motivations and preferences, which can be either intrinsic or extrinsic in fulfilling human needs of feeling competent, related and autonomous (Deci, 1975; Ryan and Deci, 2000). In addition, human behavior can be motivated by self-regarding, other-regarding and process-regarding factors as elaborated by Ben-Ner and Putterman (1998).

What motivations and preferences then drive farmers to form, run and sustain membership in cooperatives? And how reflective of the cooperative context are they? An explanation put forward by Hansmann (2000) focuses on the cost perspective, i.e. on how by joining the cooperatives farmers avoid relatively high 'market contracting costs' they would have normally incurred were they to act alone in the market and how instead they settle for relatively manageable 'ownership costs' associated with cooperative membership. In other words, viewed from this perspective, the cooperatives serve as mechanisms that guard farmers against potentially opportunistic behavior on the part of other down and upstream actors in agricultural markets (Bonus, 1986) and the price farmers pay for such a service is contained in the costs associated with cooperative membership.

However, even when the external opportunism is offset by creating a cooperative there is always a danger posed in various kinds of opportunistic behavior that can occur within the cooperative structures in relations between managers and members or even among members

themselves which is why working out a functional governance structure in cooperatives is far more complex than in other types of economic organizations. According to Iliopoulos and Valentinov (2012), the presence and persistence of opportunistic behavior within cooperative structures, both in primary and second level cooperatives, points to the need to better balance the supply and demand side explanations of the emergence of the third sector enterprises and to relate them more truthfully to realistic motivations for the emergence of such enterprises. More precisely, as argued by Iliopoulos and Valentinov, when the opportunistic behavior of cooperative leaders and management structures is driving the supply of cooperatives, as it has been for so many years in Greece, then cooperatives end up being unable to fulfill the demand side expectations, i.e. they fail to serve their members.

In the case of BiH agricultural cooperatives, the point Iliopoulos and Valentinov make on understanding the motivation for cooperative supply in relation to the reality of the context is especially relevant. As it will be illustrated later, the emergence of various kinds of internal opportunism in BiH cooperatives is particularly heightened in cooperatives with high membership heterogeneity and low levels of specialization for such cooperatives can be seen as a battleground of potentially conflicting interests. Converging different interests around unified development trajectory in such cooperatives is rather costly from the decision-making point of view which further provides incentives for opportunistic behavior. Even more radically, the cooperative legal framework in BiH allows for the supply of the so called 'family cooperatives' which neither aspire nor deliver the kinds of benefits usually sought after through cooperative form in agriculture. To mitigate such situations, members need to be better educated in terms of functioning of internal cooperative decision-making structures and processes. Clear and thorough cooperative by-laws that spell out not only the decision-making rights and processes but also the internal monitoring procedures are an imperative in making cooperatives correspond better to the needs of their members. The persistence of structures conducive to opportunistic behavior further solidifies agency problems that stem from asymmetric information and may lead to an unequal risk distribution across different patron categories as it will be shown in the case of BiH agricultural cooperatives.

Aside from safeguarding the market position of individual farmers, cooperatives should also be able to increase the earnings of individual members through cutting various kinds of costs that members would have otherwise encountered as individual producers. In the case of agricultural producer cooperatives, for example, this means that cooperative objective per se is not profit maximization for the cooperative as a separate or independent business entity but indeed a cooperative is just a tool through which its members achieve economic gain (Emelianoff, (1948) 1995). In Emelianoff's succinct words, "cooperative organizations represent the aggregates of economic units".

To erroneously assume that cooperatives function just like any other firm that maximizes its net profits often produces misleading results when estimating the market potential of cooperatives (Hirsch, 1950). In fact, observing a cooperative as strictly independent entity and then focusing on its financial performance reveals a paradoxical situation in which cooperatives, and especially agricultural ones, maximize costs rather than profits for the organization itself. In order to illustrate the paradox one needs to refer back to main objectives of agricultural cooperatives. They bring together, aggregate, a number of members who earn their income from cooperative in at least two ways. Firstly, through prices paid for products delivered to the cooperative. And secondly, through patronage refunds which depend on the frequency with which members use the cooperative and its services. Among other things, agricultural cooperatives exist to maximize the prices paid to members for their products. In fact, the prices paid through the cooperative serve as an incentive to form and join it in the first place. If cooperative was strictly observed as an organization independent from its members, these higher-than-market-prices paid to members would in fact be seen as costs observed from the perspective of the organization itself. A conventional firm tends to search for ways to minimize the prices it pays to its suppliers. Therefore, it makes little sense comparing cooperatives to conventional firms at an organizational level when financial and economic stability are analyzed. In that sense, it is very important to understand that benefits created through cooperatives have both individual and collective dimensions, in addition to being economic and social. Essentially, cooperatives represent a prime example of coordination mechanism that ought to focus primarily on its direct users. Credit cooperatives exist in order to minimize the interest rate, i.e. the cost of capital, for their members. Consumer cooperatives exist to minimize product prices for their membership base. And so on.

In light of the specificities of agricultural sector discussed in Chapter II, cooperatives often provide primary and the most important point of entry into the market for many small farmers. They are a resource-pooling and risk-sharing mechanism that is, despite its limitations, able to mitigate some of the shortcomings present in conventional firms and in the sector as a whole. Cooperative ownership structure and governance mechanism are formally, procedurally and substantively more complex than conventional firms' hierarchical structure. The cooperative form draws its substance from being a mutual benefit organization. Its membership is at once the source of its strength and can prove to be its weakness.

Cooperative strengths emanating from its membership are most visible through building of social trust among members, through the ability of members to control risk by dispersing it among themselves and to achieve economies of scale by integrating their resources and reducing the overall cost of production.

When members' interests are too diverse and consequently difficult to coordinate, then the membership itself is a challenge that can undermine the success of a cooperative. For example, heterogeneity of members' interests has often been recalled to explain relatively high decision-making costs in cooperatives that consequently have bearing on cooperative performance (Jensen and Meckling, 1979; Hansmann, 1996). The fact that cooperatives, at least the traditional ones, most commonly draw their capital exclusively from their members has labelled them as enterprises whose capital base is limited. Thus, limited membership base means limited capital. This is further seen as a source of incentive related problems that inspire changes in property rights structures in many cooperatives for which the lack of capital is an obstacle towards achieving greater levels of economic efficiency (Chaddad and Cook, 2004).

It follows from this that it is important to understand a variety of objectives that members of a cooperative may envisage when they decide to set up and run a cooperative, or in the words of Iliopoulos and Valentinov (2012: 18), we need "an analysis of the actual motives of their real-world stakeholders". What factors affect the members' perception of their objectives? And how do these objectives affect the functioning of cooperative structures and in turn their performance?

Before tackling these questions it is important to note that the benefits produced through cooperatives should ideally extend beyond their immediate membership base and into the society as a whole. However, measuring this aspect raises yet another set of dilemmas related, first, to the boundaries of society or community to which cooperatives should contribute and, second, to the exact content of the 'social' aspect and contribution of cooperatives. How deep into the community the cooperative has to be immersed for it to be seen as successful? What if the cooperative is formed by family members only? What social benefits can cooperative accrue to them that they already do not have being part of a nucleus family? Can cooperative project good practices of economic democracy into its community if the community as such is devoid of basic political democracy? These are all important questions that will only partially be tackled in this research. The social aspect of cooperative benefits has been largely understudied and it requires a much more rigorous assessment than simply stating the presence of social benefits without detailing their content. A notable exception in this regard has been the work on social enterprises in Italy (Borzaga and Galera, 2012). The nature of such organizations makes it an imperative to look deeper into their social function as they are enterprises that fill in the gap in public service provision and they do it by "reconciling equity and efficiency with the creation of economic and social value" (Borzaga and Galera, 2012: 85).

## From a simple legal entity to a functional strategic alliance

Going back to the factors that affect members' view of their objectives in relation to the overall reality, it is useful to recall the definition of cooperatives as organizations that are member-owned, member-controlled and that provide direct benefit to their members (Barton, 1989). This definition directly underlies the patron-centered nature of cooperatives.

Barton's definition of a cooperative highlights three elements worth considering in relation to specificity of cooperative enterprise vis-à-vis conventional firm especially in terms of assessing its performance. Firstly, the "member-owned" part of the definition points to the presence of a specific *ownership structure* in cooperatives. Secondly, the "member-controlled" part stresses that there is a specific *governance structure* or at the very least that the governance process is participatory and in that sense rather peculiar. And lastly, the "member-benefit" aspect essentially points out that there are multiple *objectives* that are first conceived by members and then achieved by a means of cooperative.

From the standpoint of performance, it needs to be decided whether one wishes to investigate efficiency in terms of ownership type, governance structure or members' benefits. Or more specifically, in a fashion that integrates all three elements together, we may ask how cooperative specific ownership type and governance structure increase the benefit and wellbeing of members. To take the matter even further, we may ask what elements from the ownership and governance dimensions appear to be the most conducive to satisfying members' benefits and how they may change with changing perceptions of benefits on the part of members.

Observed separately, ownership, governance and members' benefit can yield different insights into cooperative performance or for that matter into the performance of conventional firm as well. In comparing the performance of cooperatives and conventional firms, literature has placed too much focus on how well different organizational forms produce the end result, which is most commonly profit but need not be in the case of cooperatives. In this sense, internal structures represented in ownership type and governance structure are seen as instrumental to the measure of performance that may or may not be part of the enterprises' objectives. As a result, the characteristics of internal processes that underlie the structures end up being disregarded. Furthermore, this leads to a dangerous simplification in which we tend to observe 'ownership' as a unidimensional component of the enterprise. The same goes for governance structure, while in fact both are complex structures that contain a number processes the change in which may have an impact on how cooperatives respond to their members' needs. In practice, reducing these two important dimensions to just being instrumental to achieving higher levels of economic efficiency can be misleading as it may result in the conclusion that cooperative specific ownership structure and governance are altogether inadequate in producing both pecuniary and

non-pecuniary benefits for members. In line with that, it may be suggested, as it has been indeed in Chaddad and Cook (2004), that such structures should be replaced by more efficient ones that are better able to produce higher levels of economic efficiency.

Having said all this, there are essentially two ways in which misinterpretation of both ownership and governance structures on the one hand, and membership benefits' on the other can produce misleading conclusions as to the ability of cooperatives to perform efficiently in the market. First, as it was argued in the previous paragraph, when ownership and governance are taken as given and thus observed in a rather reduced context this creates a perception that economic efficiency in cooperatives can only be achieved when its internal structures are adjusted so that they resemble the conventional firms'. Second, a failure to understand that member benefits include financial gains but are not limited to them alone may result in measuring performance of cooperatives relative to wrong objectives. Either situation may undermine the worth of the cooperative model.

The fact that cooperatives are people-centred rather than money-centred businesses (Birchall, 2011), makes the member-benefit aspect of this enterprise clearly its focal point with particular ownership and governance structures being crucial to achieving members' benefits but their arrangements ought to reflect members' perception of their benefits rather than outright assumed objective of achieving more financial success in the market. Therefore, it is both worthwhile and legitimate to ask what members want, how they perceive their benefits and objectives or more importantly how they perceive the purpose of a cooperative in fulfilling them. The arrangements and processes in ownership and governance structures act as instruments aiding or limiting members' ability to achieve their individual or collective objectives through cooperatives. The point is, it is up to members themselves to decide whether they wish to use the cooperative to advance their own individual interests, which is often the case especially in settings where there is a lack of trust towards the cooperative model. Or in addition to pursuing their immediate individual interests, members may wish to engage in strengthening their social ties through the means of the cooperative, therefore strengthening the cooperative as their long term strategic alliance and for that purpose to forgo some of their immediate financial gain. Ideally, both of these should happen simultaneously. But reality warns us that this is not always the case.

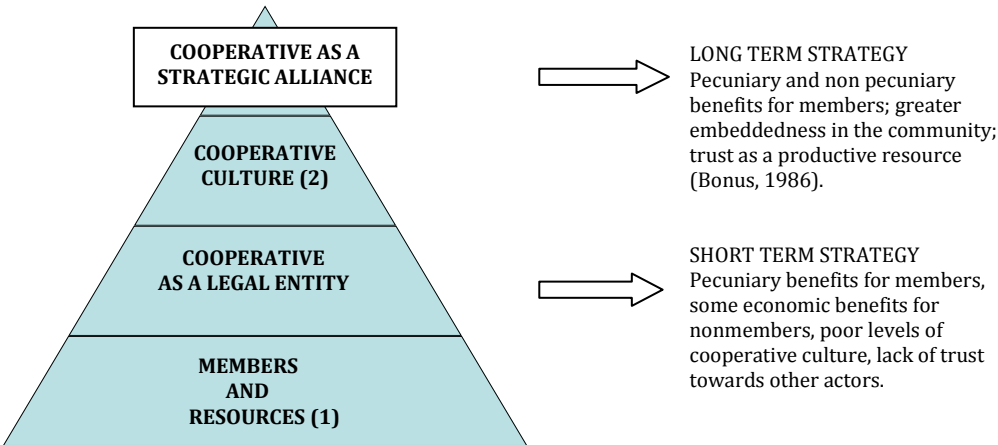
So, depending on the choice members make, there may be situations in which it is legitimate to look into how much pecuniary benefit was generated to members through a cooperative as a way of assessing its success for this may be the sole purpose of the cooperative. However, while looking into this particular aspect one needs to make an effort to understand why a cooperative organizational form was chosen to pursue usually short term pecuniary interest at the expense

of creating a more stable long term collaborative structure. What in the immediate socio-economic environment makes this choice a legitimate one in the eyes of cooperative members?

Likewise, there are cooperatives whose success cannot be measured simply by pecuniary benefits accrued to their members (and non-members) but must include a host of non-pecuniary benefits allotted to members who as a result of stronger social and relational ties existing among them strengthen their cooperative in terms of capital and assets signalling that they perceive it as a long term coordination mechanism for provision of both economic and social gains. In this way, a cooperative as a strategic collective coordination mechanism is awarded a certain status in a society, which only adds to its overall market power.

There is another way to approach this issue and it is by asking a simple question: what productive resources are needed to set up a cooperative? Though at first sight it may seem naive to pose such a question, in reality its simplicity allows us to go back to cooperative basics that are often forgotten in the analysis of their success and the role of ‘cooperativeness’ or cooperative culture in it.

Figure 4 Members’ perception of cooperative objectives and cooperative’s future



Source: Own elaboration

The figure above illustrates the point. While members and physical resources are an absolute necessity for a cooperative to exist, they suffice in creating only a legal entity registered under a cooperative name. If we add a well developed cooperative culture to these two elements, cooperatives can be transformed from a legal entity into a strategic long term alliance that yields economic and social benefits for their members and for the community. Thus, if for the sake of argument we disregard the way in which exogenous institutional factors, including various policies, shape the cooperative enterprise, what a cooperative becomes is then the result of at least two factors. Firstly, members’ perception of the content of benefits they wish to obtain through a cooperative, and secondly, members’ perception of the cooperative’s future.

If members wish to pursue only a short term strategy and use the cooperative as a mechanism through which they maximize their own individual interests sometimes at the expense of other members' interest, then cooperative is a simple legal entity emptied of cooperative culture and purpose. This is not to say that such an arrangement may necessarily be short lived, but simply that it does not embody the principles of cooperation and it cannot be expected to deliver social goods that are normally expected from and found in a true cooperative enterprise nor can it be expected to contribute to the long term development of the community. In such cases, unstable and insecure institutional environment is an asset that essentially allows the misuse of the cooperative name.

If, on the other hand, members wish to use the cooperative structure to engage in a long term, strategic collaboration with their fellows, then the productive force of cooperative culture may act as a catalyst in making the physical resources put to better use in the long run. In such instances, clarity of institutional environment is paramount to allowing such enterprises to flourish. Admittedly, the route towards transforming the legal entity into strategic long term alliance involves additional costs associated with devising the governance structure that guarantees economic efficiency of the organization.

Essentially, one can observe at least three groups of conditions that must be fulfilled in order for the cooperative to move from being simply a legal entity to becoming a long term strategic alliance of members and those are: economic conditions, properly defined governance mechanism, and trust.

More specifically, in terms of economic conditions a cooperative ought to create a set of economic incentives that would make membership attractive. Theoretically, since cooperatives do not function to earn profit for themselves but to distribute the earnings to their members they should be able to provide to them a set of benefits that include, among other things, prices that are higher than what members could get were they to sell individually in the market, easier access to finances, and some form of long term security.

In terms of proper governance structures, given the complexity of cooperatives that stems directly from the heterogeneity of members' interests, it is important that cooperatives are characterized by clearly defined mechanisms of delegation and decision-making, including the mechanisms through which members can check and balance the temporary power vested in the hands of elected and appointed managers.

The importance of trust for the longevity of cooperative enterprise is self-evident as trust, reproduced through reciprocity, is perhaps the most important component of cooperative culture. What is more, the reciprocal trust emerges and its development is facilitated much better in a social context rather than in simple individual-to-individual dealings (Fukuyama, 1995). Fukuyama (1995: 43-46) refers to cooperativeness as social virtue which when fostered



in groups 'encourages spontaneous sociability and organizational innovation'. The cooperative culture itself or 'cooperativeness' as I refer to it in this thesis can be explained in a more specific manner by using Bonus' (1986: 321) example of dependencies that are both broken and created once a cooperative is formed. By creating a cooperative, he argues, members 'internalize part of the problem' and break dependencies on a host of other market actors. However, at the same time, by joining cooperative they agree to depend on each other for the success of the enterprise and they can only agree to such dependence if the minimum of trust exists among them. That cooperative culture of trust is necessary for cooperative to become a long term strategic alliance is clear from the following:

"When a business relationship between interdependent parties demands durability in order to pay off, then the 'trust capital' (Albach, 1980) that the parties command is essential to the economic efficiency of the relationship." (Bonus, 1986: 322)

Another important aspect of trust as a productive factor emphasized by Bonus is that it grows from repeated practice. Therefore, frequent meetings of cooperative members which are generally facilitated in cooperative structures generate trust capital in the long run and position cooperatives as generators of social capital.

As it was argued before, cooperative objectives can be defined in relation to what they can do to strengthen the position of individual members, both in pecuniary and non-pecuniary terms, or what they can do to strengthen the cooperative as a collective expression of members' individual benefits and benefits for the community. In other words, members may opt for a cooperative as yet another entrepreneurial device in reaching their pecuniary gains. On the other hand, members may place considerable value in a cooperative as an instrument generating procedural fairness due to its internal leaning towards inclusive and engaging governance practices, for example. Or they may wish to use the cooperative to gain more specific knowledge on the productive processes in which they are engaged for the purpose of improving the market power of cooperative. In this sense, non-pecuniary benefits gained by members spill over into strengthening the position of a cooperative as a coordination mechanism for longer time than perhaps originally anticipated. In this sense, it is only legitimate to try and understand the performance of the cooperative in terms of how well it delivers the objectives for which it was created in the first place.

Another aspect worth mentioning is a cost perspective associated with taking either short or long term strategy to cooperative development. Acquiring non-pecuniary benefits may sometimes be costless mostly in cases when these benefits spill over from pecuniary benefits. But it must also be recognized that not all non-pecuniary benefits happen at no cost and those that are costly are financed by a portion of pecuniary benefits. Therefore, members themselves

must consciously decide that in order to gain some non-pecuniary benefits they willingly need to give up a part of their immediate financial gain. For example, they may decide to invest resources to study the possibility to accomplish better participatory procedures, and to increase members' autonomy through training and professional development. These solutions are only effective if the organization is able to realize them without significantly increasing organizational costs (Hansmann, 1996). Hence, they may well require trial and error organizational patterns to be accomplished, and this is a costly procedure.

When members do not put their financial gains exclusively in front of all other potential gains that can accrue from cooperative enterprise, they are willing to invest financially and otherwise in the cooperative itself, recognizing its long term status as a mechanism for achieving and enhancing their needs. Also, such a view and strategic leaning towards forging long term ties through a cooperative may help reduce opportunistic behaviour which is not rewarded when a group of people is looking to build lasting and strong coordination mechanism. Practically, a repeated prisoners' dilemma game may serve well in explaining why in the long run cooperation may prove to be the most strategic path to development. Through repeated prisoners' dilemma game, actors are given an opportunity to build and sustain their reputation. Knowing, or deciding in advance that their relationship will be a strategic, long term one, they each may opt for acting cooperatively first to establish their own reputation as cooperative actors and second to induce the other actor to act in the same way. In that sense, the opposite applies as well. If one actor defects, or in our case acts opportunistically, he not only establishes for himself a reputation of being an opportunistic player but also pushes the other actor towards behaving opportunistically. Repeated often enough such behavior may over time become a mainstream culture in the cooperative sector rendering it difficult and costly to eradicate.

Because members are certainly the ones who bear the cost of building the financial and status-like position of their cooperative the decision to invest in it is certainly influenced by factors that pertain to the cooperative itself but also to its external institutional environment. Sometimes, institutionally unstable and economically risky environments encourage farmers to use cooperatives for their immediate financial gains only. In this sense, members' inclination towards creating a long term coordination mechanism as well as their perception of cooperative's short and long term objectives is also a function of their legal environment and historical experiences.

A recent study on the definition of a cooperative entrepreneur suggests that what sets cooperative apart from the capitalist enterprise is in the first place its ownership structure and secondly the way in which its objectives are defined and controlled (Diaz-Foncea and Marcuello, 2013:238-239).

In this regard, in line with previously presented arguments, and as derived from the research findings, I classify cooperative objectives into two categories:

- a) Strictly individual material objectives obtained through a cooperative where a cooperative is means to an end for achieving only this category of interests;
- b) Both material and immaterial objectives defined from the standpoint of an individual member but understood to aid the transition of a cooperative from being a simple legal entity into being a long term strategic coordination mechanism.

The difference between the two is significant in as much as the former does not presume the existence of trust beyond the level necessary for provision of a basic set of economic benefits while the latter requires investments into stronger social and relational ties among members with the view of forging a more permanent and lasting coordination structure. The first kind may also be considered a simple cooperative agreement. However, in the second case the relationship between actors needs to be institutionalized and set firmly in the long lasting structures.

Indeed, cooperatives have economic as well as non-economic objectives, but their primary purpose in more general terms should be to provide conditions for stability and growth of their members' welfare (Helmlinger and Hoos, 1962). Soboh et al. (2009: 448) note that "cooperatives are successful if they provide service to their members in excess of what they can achieve individually or outside of the cooperative". In addition to providing benefits to the members, cooperatives have been found to exert impact on their non-cooperative counterparts in the market as explained by the well-known 'yardstick of competition' hypothesis (Sexton, 1990).

To conclude, one of the main research questions in the NIE tradition is the question of firms' purpose, boundaries and their relations to institutions (Coase, 1937). Using this question as a guide and keeping in line with the above defined possible objectives of real-world agricultural cooperative patrons, I view agricultural cooperatives in BiH as purposefully chosen transaction cost minimizing institutional arrangement through which farmers, in light of the prevailing institutional environment and social context, try to minimize the costs of transacting while maximizing their individual economic returns. In this way, the cooperative patrons are assumed to treat the enterprise as a 'management structure' (Roe, 1994, vii) whose performance success is subject to a number of exogenous and endogenous factors, but is in the first place informed by the perception its members hold of it as either being a short term cooperative contract or a long term institutionalized structure for generating not only pecuniar but also non-pecuniar benefits.

The prevailing perception of agricultural cooperatives in BiH is that they are marginal and inefficient enterprises. In the light of this view and theoretical assumptions presented in the first part of this Chapter, the sections that follow will provide a detailed look into context specific

organizational and institutional factors that affect cooperative efficiency as conceived in this study. To start with, the next section will outline the context peculiarities of the present research, provide data description highlighting its main limitations, and explain the methodology used in the analysis of the efficiency determinants for 210 BiH agricultural cooperatives.

## Context, Data, and Methodology

Previous chapters laid out the basis background to the subject matter of this research. The BiH context is unique in many respects, its political structure being just one of them. It is a good example of a post-conflict and still developing country struggling with path dependencies and volatile and unsupportive legal context. Bosnia's reliance on agricultural sector for providing livelihood support to many rural families as well as the evolutionary path of its cooperative movement make the study on the dynamics between institutional setting and cooperative form all the more important and pertinent.

While any development oriented action by BiH government is limited by its own systemic deficiencies, farmers on the other hand have expectations that very much resonate past regime experiences – they demand a greater involvement of the public sector in planning and supporting agricultural activities. In such a context, farmers appear to be mainly risk averse and are reluctant to meet the market alone. This is very much reflected in how they perceive their cooperation in agricultural activities. Additionally, the violent four-year long war left Bosnian society almost completely devoid of person-to-person and person-to-institution trust. Transition from war to peace and out of socialism towards open market economy further solidified this lack of trust in Bosnian society making cooperation more difficult than anyone could have anticipated.

In such a volatile and information-poor context, gathering data was a great challenge. As a result, the data for the analysis presented in this chapter were collected from multiple sources and refer to year 2011. The fieldwork centred on gathering organizational characteristics was carried out by the FARMA project staff and was later supplemented by the researcher's personal field work especially on matters related to social property in cooperatives. The questionnaires were usually filled either by directors themselves or by cooperative members close to directors in the presence of FARMA hired individuals for data gathering. After data was compiled into a database, a number of cooperative directors were interviewed about the most interesting (or otherwise unclear) aspects of information obtained through the questionnaire. A total of 32 interviews were carried out.

Financial data was obtained from the currently most reliable AIIFS agencies in BiH and was supplemented by the data from the database of the Cooperative Association on BiH which

contains information on 313 cooperatives, a number which cannot be taken as fully reflecting the cooperative sector in BiH since many cooperatives listed in this database are currently inactive. To establish whether these cooperatives are active or not a phone contact was attempted by the researcher with all listed cooperatives.

Data thus obtained were supplemented by six interviews with staff of the Cooperative Association of BiH and additional two interviews with high ranking civil servants in Ministry of foreign trade and economic relations of BiH. All of them provided valuable insights into the situation in the cooperative sector of BiH.

The econometric estimates in this chapter are derived using the OLS regression analysis in which the cooperative efficiency, defined by return to contributions of products to the cooperative, is regressed against a number of variables which are both internal and external to cooperatives themselves. The following is a description of variables used in the analysis.

## Variables and hypotheses

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The research results presented in this chapter convey information on the main determinants of agricultural cooperatives' efficiency for the sample of 210 active agricultural cooperatives in BiH. The following is the list of dependent and independent variables including the hypothesized relationships between them.

### Cooperative Efficiency as a dependent variable

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In the light of Bosnia's very peculiar institutional context as well as historical evolution of the idea of cooperation, it is important to spell out the understanding of efficiency employed for the purpose of the present analysis. The aim of the preceding sections was to give a context in which two important cooperative dimensions, namely 'cooperative objectives' and 'patron-centered nature' of cooperatives, interact to inform the choice of the efficiency measure selected for this research. The choice of the efficiency measure hereby presented reflects what researcher believes to be the true motivations behind cooperative patrons' interest in cooperatives.

To connect the theoretical propositions presented in the first part of this Chapter to the empirical framework of the inquiry that is being proposed here, I put forward a view that a measure of cooperative performance is to be sought in the critical relationship of farmers to their cooperatives. In the view of Pascucci, Gardebroek and Dries (2011:53) this relationship is "characterized by three components: the allocation of value; the allocation of uncertainty and the allocation of property rights." However, in light of the previous chapters' findings I propose that an estimation of cooperative performance has to acknowledge not just these three dimensions but also how the patrons' perception of their objectives relates to the practices of cooperation carried out through cooperative structures. In other words, as argued in the previous section, the way patrons envisage both their objectives and the role of cooperatives in

fulfilling them will inform the way in which value, uncertainty and property rights will be allocated within the cooperative and with which degree of success. Therefore, I put emphasis on both cooperative objectives and the role of patrons in cooperatives when trying to define the measure of cooperative efficiency.

The role of patrons in BiH agricultural cooperatives is complex for at least two reasons. Firstly, the category of patrons is generally composed of diverse sub-categories with varying rights and interests. This indeed is very pronounced in the case of BiH cooperative sector in which both cooperative members and non-members or cooperants are integral part of the cooperative enterprise. The impact of dynamics between these two categories of patrons is seen to be an important determinant of cooperative efficiency in economic terms precisely because it is the patrons who shape the cooperative purpose and dictate the activities carried out through cooperative structures. This leads us to the conception of members' objectives. Since the context being studied in this thesis is transitional both in terms of post-conflict and post-socialist transition, its institutional edifice is volatile, unstable and risky. Within such an environment the behavior of economic actors is likely to be geared towards achieving immediate and short term gains at the expense of long term development. In terms of cooperatives, this translates into using cooperatives by both members and cooperants mainly in commercial and economic purposes, an equivalent of the first typology of cooperative objectives presented earlier. Given the environment and the experiences with the cooperative model so far, the view of cooperative efficiency as used in this research reflects the predominant perception in BiH that cooperatives are enterprises that in reality are used to generate pecuniary benefits for their patrons.

The measure of efficiency used in this chapter was thus calculated in the following manner:

$$(Formula 1) \quad \text{Coop Efficiency} = \frac{\text{Monetary gain to Members} + \text{Monetary gain to Cooperants}}{\text{Number of Members} + \text{Number of Cooperants}}$$

The amounts paid to members include both gains from placing their products through cooperatives as well as end-of-the-year benefits distribution. The monetary gains of cooperants include only the prices for goods they place on the market using a cooperative. This calculation also allows observing a measure of performance related to the total number of producers involved. In many cooperatives the main producers are cooperants who are often greater in numbers than members and are able to generate the greater value of production delivered to the cooperative. Hence, the per capita gain which includes both members and cooperants paints a more complete picture of economic efficiency in strictly monetary terms than if only members were considered.

Furthermore, cooperatives surveyed are focused exclusively on providing economic benefits to members with only isolated cases of cooperatives that experimented with providing training and education to members. In general, the provision of latter services is deemed costly and even if it is provided it is usually financed by donor means rather than by cooperative investments. Therefore, provision of benefits that surpasses the economic ones is incidental rather than common. As a result of that, the analysis presented here looks into internal and external determinants that help explain efficiency in strictly monetary terms. The following is the list of independent variables used as well as their hypothesized relationship to the dependent variable.

### Cooperative size

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The size of the cooperative is estimated by using cooperative total assets as a size indicator. It is not uncommon to use the measure of total assets to approximate the size of the cooperatives especially when financial data are used to understand the material efficiency of cooperatives (Boyd et al., 2007). Additionally, it has been shown in the literature that the size of the cooperative may be a significant factor in explaining its performance levels not least because agency and supervision costs may both vary with size (Huang et al., 2013). Furthermore, larger cooperatives may allow for a better use of economies of scale and scope for members.

On the other hand, there are studies of cooperative performance which use number of members as indicator for cooperative size and cooperatives' total turnover divided by number of members as an indicator of its efficiency (Bijman et al., 2012). Although insightful such measures are not very useful in the case of this research primarily because of the member-cooperant dynamics that somehow needs to be accounted for.

Therefore, based on the literature reviewed in Chapter II and in this Chapter, the following hypothesis is tested:

*(Hypothesis 1) Larger sizes of cooperatives are associated with higher levels of cooperative efficiency.*

### The Cooperant-Member Ratio

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Due to cooperative member-centered nature, the membership in a cooperative has traditionally been an important research topic. However, the studies are mostly centred on estimating whether or not membership in a cooperative is associated with the development of small scale agriculture (Vandeplas et al., 2013; Ito et al., 2012).

One of the challenges cooperatives face in competitive markets is the fact that their up and down stream partners are usually organized in a form of investor owned firms (Tortia et al., 2013). So, the business logic differs along the value chain making it quite demanding for cooperatives to keep up with strictly for profit enterprises. However, despite the fact that on

everyday basis cooperatives have to collaborate with a number of actors on an individual or organizational level, very few studies actually explore the relations of cooperatives to the external world of other actors on which cooperatives depend for their survival and functioning.

Several studies tackle outside of cooperative relationships through exploring the supportive network of organizations which are formally not part of the internal cooperative structure but may act as a professional network that supports the development of cooperatives either in the form of second level cooperative or cooperative development agency (Dickstein, 1986; Russel, 1991). Some authors have also looked into the role of and relationship between local banking industry and cooperative development (Gagliardi, 2009). The relationship between non-members and cooperatives has rarely occupied scholars' attention.

Since cooperants, or non-member suppliers, are such an important part of cooperative sector, it is crucial that they are examined within the context of cooperative efficiency. More so because of the fact that while they appear to use the cooperative rather intensively to place their products on the market, they do not share in the benefits of governing the enterprise. Therefore, considering their role in the cooperative sector is especially important in the view of the fact that one of the peculiarities of cooperative organizational form is a shared ownership structure. Naturally, such a structure makes members, their rights and duties the main focus in studies that assess the cost effectiveness of such ownership and decision making models. However, sometimes non-members may be just as interesting category in understanding the functionality of the cooperative model. The case of BiH cooperants is rather peculiar in this regard owing to the specific historical experiences that gave birth to this non-member category of cooperative patrons.

In the specific BiH context, two groups of patrons can be distinguished: members and cooperants.<sup>48</sup> Cooperatives being member-centered organizations, it is rather common to examine benefits members derive from their cooperative. However, to understand better the measure of efficiency in this context and why cooperants are included in it, a brief explanation of the category of 'cooperant' is in order.

The analysis contained in Chapter IV highlighted institutional and policy changes that took place in the former Yugoslavia from after the WWII until its demise. In that socialist episode that lasted for several decades, especially during its initial phases in the late 1940s and early 1950s, when almost all farmers were required to be engaged and involved in cooperatives, membership often entailed giving away one's private property to local cooperatives. As a response, the category of a 'cooperant' begun to be used fairly often as a loose form of cooperative membership that practically translated into farmers having a simple, usually purely commercial, association to cooperative without being full members. It warranted farmers a channel through

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<sup>48</sup> The Bosnian word for this is 'kooperant'. For lack of a better word, the loose translation of the term to 'cooperant' is used.



which they could place their products without really pooling their privately owned resources or paying membership fees. At the same time this meant that cooperants had no decision making and governance rights in the cooperatives which they extensively used for their economic activities. The category of cooperant persisted until today and is as widespread as ever.

While cooperants are regular suppliers to their cooperatives they can at the same time collaborate with private processing firms without having to place all of their goods through cooperatives. For them, cooperatives act as middleman in the market and are under no legal obligation to afford them favourable prices the way they should do for their own members. In other words, cooperants are non-member farmers who use cooperatives either because they have no other way to reach the processors in a particular industry, or just as an alternative source of income. In BiH case, cooperants are often those farmers who are too small, financially and otherwise, to become full members of local cooperatives but would still like to use it in order to facilitate market placement for some of their produce.

Interestingly enough, the majority of BiH cooperatives have both full members and cooperants. In many cases, the number of cooperants is far greater than the number of cooperative members. One may wonder whether cooperants ever become cooperative members. Yes and no. Cooperative management can be very restrictive when it comes to inviting cooperants into the membership base. Sometimes barriers to entry are formulated in a way that requires cooperants to collaborate with cooperative for a specific period of time before being allowed to apply for membership. For some cooperants, membership never becomes a realistic prospect because of high financial barriers to entry in addition to administrative barriers. Because cooperants appear to be a rather frequent phenomenon in BiH cooperative sector, it is important to take them into account when assessing the economic impact a cooperative has on all its patrons on an individual level.

Therefore, calculating the cooperant-member ratio was an important aspect of understanding to what extent cooperatives depend on their non-members to carry out their productive activities. Since a cooperative is understood to be a member-centred enterprise, this research assumed that cooperatives with too large a difference between the number of members and cooperants could reveal a lot about the nature of cooperative enterprises in BiH.

The ratio was calculated following this formula:

$$(Formula 2) \quad \text{Coop to Member Ratio} = \frac{\text{Number of Cooperants}}{\text{Number of Members} + \text{Number of Cooperants}}$$

The scores for all 210 cooperatives range between 0 and 1. The closer the score to 1 the more intensive is the role of cooperants in a cooperative. Conversely, the closer the score to 0 the more significant is the role of members in a cooperative.

As for this independent variable, the following relationship to dependent variable is hypothesized:

*(Hypothesis 2) The cooperatives in which the ratio of cooperants to members is higher tend to show higher levels of economic efficiency.*

The relationship hypothesized in such a manner reflects the general transitional context as well as the overall treatment of cooperants by the cooperatives to which they are associated. First of all, the legal context is rather unclear as to the role of cooperants in the total turnover of the cooperative. There is even less clarity as to whether or when cooperants should be admitted to full membership. As far as cooperants are concerned, to them there is no real difference whether they sell their products to the local cooperative or some private business in the same sector. However, the fact that they place their products on the market via cooperatives is not so much a reflection of their choice but is rather an expression of necessity. It is likely that the cooperative is the only buyer in a particular rural area, and that buyer to them is the only chance to reach bigger urban markets while avoiding the costs of searching for final costumers and transportation costs.

Cooperative, on the other hand, has no obligation to provide supplies for the cooperants at a favorable price. In fact, there are no legal guarantees of the longevity of the relationship between the cooperative and its cooperants. The contractual relationship between them presumes only that the cooperative pays for the goods that cooperants deliver to it, and the contracts they sign with the cooperative are often not of the long term nature. In fact, there have been many cases where both cooperative has failed its cooperants and vice versa. Therefore, opportunistic behavior is not a rare occurrence. For example, there were cases where price of the product to be delivered by the cooperants was included the agreement between them and the cooperative. However, once the good was delivered the cooperative refused to pay the agreed price and instead offered to pay a lower (sometimes much lower) price than the agreed one. Having no other option but to sell to the cooperative, the cooperants were forced to sell the goods at a lower price.<sup>49</sup>

The perishable nature of the goods produced and the lack of storage capacity for many small cooperants add to their overall vulnerability vis-à-vis the cooperative. This highlights a dramatic departure of the cooperative model often practiced in BiH from what the theory of cooperatives suggests such models should do. Hansmann (2000) argues that one of the main rationales

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<sup>49</sup> Personal interview with the project manager of the Cooperative Association of BiH, May 2012.

behind the existence of cooperatives is that they replace or rather displace the middlemen from the market thus protecting the farmers from potential opportunistic behavior. However, the cooperative model as practiced in BiH illustrates how an unbalanced relation between the frequency of usage of cooperative and ownership and governance rights may in fact turn the cooperative into the exact middlemen it was set out to replace. The user-beneficiary tension in this case opens up a space for opportunistic behavior that potentially turns the cooperative into the profit maximizing device for its members.

On the other hand, cooperatives have also reported various instances in which cooperants failed to honor the contract by deciding to sell to an ad hoc buyer who offered a higher price than what was contractually agreed between them and the cooperative. In this way, the cooperatives were left unable to deliver the quantity of goods they previously agreed on with the processing industry.<sup>50</sup> However, this has been a much rarer scenario than the one described in the previous paragraph. Such behavior on both parts contributes to decreasing trust among members and cooperants and further slows down cooperants' integration into the cooperative structures.

Furthermore, it was brought to the attention of the researcher that cooperatives incur a number of administrative costs related to handling the members' business and a great number of cooperatives was not keen on expanding the membership in order to keep the costs of running the cooperative lower, and especially not by including cooperants whose capital contribution to the cooperative would be negligible.<sup>51</sup>

Nevertheless, the matter of the fact is that the long term impact of greater numbers of cooperants vis-à-vis proper cooperative members on the cooperative identity of these enterprises was never properly studied by relevant policy institutions or cooperative apex organizations. This category seems to be taken for granted as some sort of historical continuity. However, one view on the role of cooperants in cooperatives repeatedly came through as rather relevant: in an alarmingly large number of cooperatives, management and members tend to have unscrupulous attitude towards cooperants profiteering from their economic activities while denying them the decision-making rights on the grounds of their vague status<sup>52</sup>.

Given the knowledge of the context and cooperative sector as a whole, this has led me to believe that cooperatives with unproportionate numbers of cooperants compared to members could exhibit better economic performance.

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<sup>50</sup> Similar concerns were raised in a number of personal interviews with heads of cooperatives when asked about the dynamics between members and cooperants in their cooperative and prospects for membership for cooperants, June-September 2011.

<sup>51</sup> Personal interviews with cooperative heads, September 2011.

<sup>52</sup> Personal interview with the director of the Cooperative Association of FBiH, October 2011.

## The Power structure in cooperatives

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One of the main principles of cooperation through cooperatives is that members hold control rights over productive processes and related decisions in their cooperative. Although there exist a clear internal organizational structure of governance and management bodies, cooperatives are endowed with mechanisms which ensure an equal right to participation to every cooperative member. In other words, directly or indirectly members run their cooperatives and their control rights come not from capital per se but rather from their continuous usage of their cooperative (Novkovic et al., 2012).

However, through his coalition theoretical framework, Staatz (1986) argues that even in cooperatives there exist groups with competing interests that are willing to misuse the structures in order to reach their individual goals. While this may be valid, it does not dismiss the value of democratic procedures that are organic to cooperative organizations and enshrined in the ICA principles of cooperation. What is more, the democratic foundations of cooperatives are strengthened by values of reciprocity, loyalty and certain business ethics making cooperatives not just a business entity with a structure different from the IOFs but an entity with an entirely different purpose (Zamagni and Zamagni, 2010).

Also, Novkovic et al. (2012) argue that the participation in cooperatives cannot be simply equated with the worker participation-enhancing strategies tried out by conventional firms in order to empower their employees. Instead, they recall a contribution by Stocki, Prokopowicz and Zmuda (2010) and argue that cooperatives practice what is called a 'total participation approach'. In fact, worker cooperatives in particular are "treated as a special case of full participation" (Novkovic et al., 2012: 3). Furthermore, Ben Ner and Jones (1995) show that meaningful participation in an enterprise can have positive effects on organization's overall productivity, especially if the benefits of participation can be reduced to and felt at an individual level and are greater than cost of participation.

For the purpose of the present analysis, I define participation as knowledge of and participation in internal decision-making and monitoring processes in a cooperative regarding both long term strategic decisions and every day decisions to the degree defined by members' position in cooperative structures and cooperative internal documents. These participation rights by default belong to members but the degree to which they are exercised depends on a member's position within cooperative structures but also on how well defined and articulated the processes of decision-making are themselves. The clarity in both is necessary for a meaningful participation in a cooperative.

In this particular research, it was important to understand the power structure as related to effectively exercised decision-making rights over three different categories of issues: every day operations, long term decisions and strategic control. A number of questions were asked to

understand who in a cooperative gets to decide on routine matters like everyday purchases, on slightly more important issues like long term purchases and production priorities and strategic questions like choosing a director and deciding on the distribution of the excess revenues. In an attempt to explain the micro and macro level of decision-making in a cooperative, five categories of cooperatives with respect to their internal power structure emerged, namely: very consolidated, consolidated, normal, diffused and very diffused.

Based on these findings and insights, the following is hypothesized:

*(Hypothesis 3) The greater the participation of all members in governance of cooperative the better its economic efficiency.*

## Social property

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Mainstream economics generally recognizes two types of property ownership, namely private and public. However, there are ownership types which, due to a diverse mix of historical, social, political and economic reasons do not fully comply with this dichotomy. An ownership type that is in post-Yugoslav countries known as 'social property' is most commonly used to denote the property that once was either private or public in nature but at some point in time usage rights and later ownership rights over the property were given to a number of collective organizations such as cooperatives. Social property in this context does not mean socialist property or state property. The word 'social' here denotes the ownership rights held literally by the entire society, reflecting mainly the ideological postulates of then socialist Yugoslavia.

In any case, social property viewed in the present day Bosnia is in fact taken to mean the property the legal status of which is unclear since the category of social property is not currently recognized in BiH institutional environment. Cooperative sector in BiH as a whole is burdened by the fact that rights over social property were never clearly assigned to any actor until the adoption of the General Law on cooperatives in 2003 when such property in the cooperative sector was to become cooperative property, yet another category not familiar to most legal systems in Europe. However, the implementation of the Law fell short of expectations.

There is an extensive literature on the importance of clearly defined and assigned property rights to organization's productivity. An entire stream of scholarly literature known as 'property rights school' has produced numerous studies that point to an important connection between clearly delineated property rights and economic efficiency of organizations. Alchian and Demsetz (1967) have been the most vocal representatives of the school.

The main argument Demsetz (1967) puts forward in favour of clearly defined property rights, preferably private, is that they help guide incentives towards creating mechanisms that

best internalize many externalities present in our institutional environment. The incentives that may be distorted by unclear property rights are incentives to work on property, invest in it, use it as a collateral, lease or sell it. All of these functions of property are limited if the ownership rights are not clearly assigned.

Therefore, the hypothesized relationship between the presence of social property in cooperatives and their economic efficiency is as follows:

*(Hypothesis 4) The presence of social property in cooperatives is negatively related to cooperative efficiency.*

## Other independent variables

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Aside from the above listed independent variables, the analysis aimed to include a number of variables that could depict the effect of cooperative year of formation on its economic efficiency, as well as the impact of sector in which cooperatives function on their economic efficiency. To that end, it is hypothesized that cooperatives formed after 1995, i.e. when Dayton peace agreement was signed, should show greater levels of economic efficiency. The assumption here is that cooperatives originating from the socialist period would be burdened with a lot of path dependency issues bringing down their economic efficiency.

As regards the sub sectors of main activity, the aim was to see if cooperatives show greater economic efficiency in any one of the sub-sectors. Classifying cooperatives into distinct sub-sectors such as dairy, fruits and vegetables, wine, etc. was very challenging since most of cooperatives reported to perform in more than one of these sub-sectors. In fact, most cooperatives are considered to be general cooperatives with very few specializing in just one activity. Most common combinations of sectors were animals and dairy; dairy, fruits and vegetables; poultry and vegetables. To simplify classification the first sub sector listed was taken as primary sector of activity. Therefore, five categories emerged, namely: animals and dairy; poultry; cereals; fruits and vegetables; medicinal and aromatic plants and honey.

## Results and Discussion

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### Cooperatives in numbers: an overview

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In 1964, there were 264 agricultural cooperatives in Bosnia (Bešlija and Pajkić, 1978). In 2014, the numbers are not certain but estimates suggest that there are no more than 260 agricultural cooperatives and not all of them are active. At the time when cooperative enterprise as an organizational form is growing both in numbers and importance across Europe, it is puzzling as to why the numbers of active cooperatives in BiH seem to be stagnating for quite a long period of time. What follows in this section is an attempt to elucidate this matter at least partly.

The cooperative sector of BiH is far from being homogenous. One observation of the sector as a whole is that cooperatives tend to be of general nature with very rare cases of specialized cooperatives. Most of cooperatives engage in more than one activity in a sense that they are involved in getting supply for members and organizing productive activities in various sub-sectors for both members and cooperants. They rarely get involved in common marketing activities. Those that do were formed after the war and their set up was assisted by international organizations and they continue to be supported both financially and expertise wise by the same organizations.

Their sizes, measured either in total assets or membership, vary too. It is however possible to distinguish between various clusters of cooperatives with some common characteristics and consequently to group them up on a number of criteria:

- (1) By the time of formation: Cooperatives formed before the introduction of socialism; cooperatives formed during the socialist regime, and cooperatives formed in the aftermath of the socialist regime demise in the 1990s.
- (2) By the intensity of members-cooperants participation: Three distinct categories appear in this regard: cooperatives in which the number of members is greater than that of cooperants, cooperatives with greater number of cooperants compared to members, and cooperatives composed only of members.
- (3) By the size of membership: As it was indicated earlier, considering members in cooperatives alone without paying attention to number of cooperants associated to cooperative gives only a partial picture in terms of cooperatives' outreach. However, if only members are taken into account several categories of coops emerge: very small cooperatives with 5 to 10 members (a legal minimum), from 10 to 100 members (most of pre-1995 cooperatives fall into this category, over 100 members).

Basic descriptive statistics on their characteristics is summarized in the following tables.

Table 7 Descriptive statistics of the sample

Variable	Obs.	Mean	Std. Dev.	Min	Max
Revenues <sup>53</sup>	210	461340	1234812	27	1.05 mill
Number of employees	210	4.4	6.78	0	57
Total assets	210	1546439	6533608	41	83.5 mill
Members	210	3.62	9.46	4	1005
Cooperants	143	179.82	436.5	0	3500

Source: Own calculation

<sup>53</sup> The currency unit is KM – Convertible mark, a local BiH currency. It is fixed to EURO at the rate of 1.995 KM = 1 EUR

Table 8 Indebtedness of cooperatives

Cooperatives	Number	Short term loans <sup>54</sup>		Long term loans	
		Total	average	total	average
<b>Pre-1995</b>	43	2489471.00	57894.67	4114838.00	95693.91
<b>Post-1995</b>	167	5125576.00	30692.00	6247088.00	37407.71

Source: Own calculation

In terms of indebtedness, cooperatives formed after 1995 appear to be more indebted. This can be ascribed to several reasons. First of all, the overall numbers of cooperatives in these two categories is very different which affects both the total amount of loans and averages. Secondly, most of the newer cooperatives are also led by younger management which seems to be less risk averse than old, traditional style cooperatives' directors. And finally, many of the pre-1995 cooperatives are burdened by the presence of property with unresolved legal status which makes it difficult for them to borrow capital on the market.

In terms of the sample studies, the numbers of cooperatives in Republika Srpska and Federation of BiH are 96 and 114 respectively. There is, however, a stark difference in numbers of cooperatives that reported economic activity in 2011 with regards to their year of formation. Only 43 cooperatives formed before 1995 reported some activity in 2011, while the rest of the sample is composed of cooperatives formed after 1995. A more detailed analysis suggests that most of the 'old' cooperatives have a much wider membership base, or numbers of members and cooperants are not so different. On average, there are fewer of pre-1995 cooperatives that have the legal minimum of five members compared to cooperatives formed recently. More specifically, a total of 9 cooperatives were set up before 1995 with fewer than 10 members. On the other hand, in the post-1995 period, a total of 78 cooperatives have less than 10 members.

When the number of cooperative founding members was compared to the current number of members, it was noted that for 117 cooperatives from the sample studied the number dropped or remained the same. Out of those 117 cooperatives, 20 were formed before 1995, while 97 were founded after 1995. The trend of the decreasing number of members is worrisome especially keeping in mind the fact that the numbers of cooperants have not followed a similar trend.

It is interesting to note that 143 cooperatives out of 210, or around 68% of them, reported to have some number of cooperants with maximum number reaching 3500. This information further emphasizes the need to analyse the position and importance of cooperants in relation to cooperatives themselves and their members. Do these numbers suggest that many of agricultural cooperatives in Bosnia violate the very principle of cooperation that states that cooperatives should serve their members who control cooperative activities by having a democratic right to cast their vote on a one-member-one-vote basis? Are cooperatives that have

<sup>54</sup> The currency is local KM – Convertible mark.



only a few members, say 10 or less, and hundreds of cooperants truly cooperatives, or just another middlemen in the market using a cooperative name as a label for purposes of personal gain? These are legitimate questions that will be tackled in the reminder of the discussion.

## The model

The investigation into determinants of current efficiency levels in BiH agricultural cooperatives as measured by individual financial gains of members and cooperants, however limiting this approach may be, suggests that four factors in particular are significant determinants of cooperative efficiency, namely the cooperative size as measured by its total assets, presence or absence of social property, cooperative power structure and cooperants-members ratio.

The ordinary least square methodology was used in the estimation and the following model was specified:

$$EFF(\text{coop}) = \beta_0 + \beta_1 \text{Assets} + \beta_2 \text{C\_M ratio} + \beta_3 \text{Power\_Structure} + \beta_4 \text{Social\_Property} + \beta_5 \text{Poultry} + \mu$$

The results presented in the Table 6.4 indicate that cooperative size measured by total assets, cooperant-member ratio, power structure, social property, and sub-sector of poultry all appear to be significant in explaining the measure of cooperative efficiency as used in this chapter. No significant multicollinearity exists between the variables.

Other independent variables that were looked into included the geographical location (dummy for entity), government subsidies, other sub-sectors but they do not appear to be statistically significant in explaining the efficiency of cooperatives.

Table 9 Determinants of cooperative efficiency in BiH

Source	SS	df	MS
Model	9.78E+15	5	1.96E+15
Residual	2.42E+16	204	1.19E+14
Total	3.40E+16	209	1.63E+14

Number of obs =	210
F( 5, 204)	16.45
Prob > F	0.0000
R-squared	0.2874
Adj R-squared	0.2699
Root MSE	1.1E + 0.5

Cooperative Efficiency	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
coop total assets	28421.52	8.558.383	3.32	0.001	11547.29	45295.75
cooperant to member ratio	60657.16	19305.21	3.14	0.002	22593.82	98720.49
very consolidated power structure	67260.42	18543.37	3.63	0.000	30699.19	103821.7
social property	-42845.33	20627.53	-2.08	0.039	-83515.82	-2.174.842
poultry	231617.6	40098.27	5.78	0.000	152557.4	310677.8
_cons	-155007.5	45475.41	-3.41	0.001	-244669.6	-65345.44

As regards the potential endogeneity problem, owing to the nature of dependent and independent variables, i.e. dependent variable being the economic outcome variable expressed

in monetary terms and independent variables being institutional, it is possible to argue against the presence of endogeneity problem. Therefore, it appears safe to state that while institutional factors influence the outcome, the reverse relation does not hold, for sure not in the short run. Indeed, it would be possible to hypothesize that different outcomes influence the governance structure, because different outcomes may impact on the style of leadership chosen by the cooperative, and on the way leaders are selected and empowered for example. However, this effect, if present, is likely to take place in the medium to long run and may be observed in the future, while different institutional solutions impact on outcomes also in the short run. This effect can be more readily observed. The results concerning property rights are likely to suffer still less from reverse causality bias since they are directly regulated by law.

The sections that follow discuss each independent variable separately.

### The cooperative size still matters

Consistent with some other research (Ariyaratne et al., 1997; Krasachat and Chimkul, 2009), and in line with hypothesized relationship between efficiency and cooperative size, the results presented above confirm a positive relation between the size of cooperative measured by its total assets and its economic efficiency. Therefore, the first hypothesis can be accepted as indeed, cooperatives with larger sizes not only provide greater economic efficiency as indicated above, but their size can also be informative of their overall market power and ability to help farmers reach both economies of scale and scope through having access to storage capacities or by participating in joint processing activities. Indeed, one of the generic reasons for cooperatives to emerge in the first place is their ability to cut on production costs for individual farmers. Larger cooperatives in terms of total asset worth could be more prone to investing in specialization efforts and therefore further increasing economic efficiency. In that sense, they can be seen as agents of structural changes in agricultural sectors populated by small and fragmented farms.

### For members or for non-members?

The second hypothesis predicted that cooperatives with higher cooperant to member ratio tend to show better economic performance. Based on the results presented above, this hypothesis can also be confirmed. The cooperant-member ratio seems to be significant in determining the levels of economic efficiency in cooperatives. In other words, cooperatives that have very few members and large base of cooperants tend to have better economic performance. In essence, this means that out of 210 cooperatives examined those that in terms of their member-cooperant structure appear to be hierarchical (less members govern more cooperants) are better performers. While this may be at odds with the assumptions stemming from theoretical

works on cooperatives, it can well be explained given the findings presented in chapters IV and V, and a general understanding of the predominant cooperative model in BiH.

First of all, results supporting the second hypothesis are also in line with information acquired through qualitative data gathering whereby it was consistently brought up to the researcher's attention that to many cooperants cooperatives with which they collaborate are nothing more than another middleman in the market. Such finding begs the question about the practice of cooperative principles in relations of cooperatives to their external partners. What is more, cooperative directors interviewed suggested that in principle there is no difference in the prices paid to members and cooperants for goods delivered to the cooperative. There are, however, cases where prices paid to cooperants appear to be lower than agreed due to instances of opportunistic behavior which was not perceived as such but was justified by the changes in the market prices and general volatility of agricultural market in BiH. This raises two different but interrelated issues.

The first issue is concerned with the very nature of cooperatives. If the ratio of cooperants to members is taken to, at least partly, reflect the nature of predominant cooperative model, it is clear that the understanding of cooperatives' purpose is limited both formally and substantially. These limitations preclude cooperatives from becoming an enterprise which serves members' wellbeing both by satisfying their monetary as well as non-monetary needs. Even Hansmann (2001), who is often very critical of cooperatives' ability to compete with for-profit firms with the same level of economic efficiency, suggests that one of the main reasons cooperatives get to be established in the first place is to eliminate the middlemen from the market. Given the numbers of cooperatives that exhibit the disbalance with regards to cooperant-member participation in productive activities it is legitimate to question the identity and purpose of those cooperatives which opt to behave precisely as middlemen towards those farmers who happen to carry out a bulk of their productive activities.

The second issue concerns the attractiveness of membership itself. If members and cooperants derive the same kind of benefit from participating in cooperative through no difference in prices offered for their goods, then it is clear that there is no proper incentive structure for increasing the membership and decreasing the number of cooperants on which cooperative relies in order to reach the quantity of goods that it wishes to place on the market. As it was brought up repeatedly by cooperative directors<sup>55</sup>, there are essentially two benefits members derive from cooperative. Members get to benefit from redistribution of excess revenue at the end of the year. And sometimes, when there is fixed quantity of goods that can be sold by a cooperative down the value chain members get to be prioritized over cooperants in placing their

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<sup>55</sup> Personal interview with three cooperative directors, November 2014.

goods first. In such instances, the contracts are of little value as their implementation is affected by potential shocks in the market demand for the product.

Additionally, many cooperatives are openly closed to new members in a sense that they consciously place high barriers to entry for any potential new members thus violating another cooperative principle of open and voluntary membership. Given that the only difference between members and cooperants is in the right of members to appropriate excess revenues at the end of the year, members have a clear economic incentive to keep cooperatives closed to new members.

It is instructive to look into the total number of cooperants and compare it to number of members in pre- and post-1995 cooperatives to understand the scale of the problem. As it is visible from the table below, a total of 18 225 cooperants are affiliated to post-1995 cooperatives while this number is much smaller for pre-1995 cooperatives.

Table 10 Number of members and cooperants in cooperatives formed before and after 1995

Cooperatives	Number	Members		Cooperants	
		total	avg	total	avg
<b>Pre-1995</b>	43	2926	68	7491	242
<b>Post-1995</b>	167	4678	28	18225	168

The numbers in Table 10 reveal that there are more cooperants associated to the post-1995 cooperatives than members in the whole sample of 210 cooperatives. Fruthermore, as can be observed from the same table, the average number of members in pre-1995 cooperatives is 68, while this number stands at 28 for post-1995 cooperatives. Although pre-1995 cooperatives have cooperants as well, their membership base is much wider than is the case with younger cooperatives. The General Law on cooperatives in BiH allows cooperatives to work with non-members but it is silent as to the magnitude and range of cooperation of a cooperative outside of its membership base. Furthermore, there are no fiscal incentives for cooperatives to uphold the principles of participatory cooperative governance as practiced in many advanced economies in Europe.

When cooperatives are further broken into several categories based on the size of membership, the following information on cooperants-member dynamics emerges.

Table 11 Members and Cooperants in cooperatives classified by size and year of formation

	No. Of members	Members		Cooperants		C/M Ratio Average
		No of coops	Total members	No of coops <sup>56</sup>	Total cooperants	
Pre-1995	< 10	9	54	7	284	0.6
	10 - 50	24	477	15	1954	0.44
	50 - 100	5	313	4	875	0.53
	> 100	5	2082	5	4378	0.42
Post-995	< 10	78	470	45	8773	0.44
	10 - 50	65	1253	48	5038	0.49
	50 - 100	13	836	10	767	0.32
	> 100	11	2119	9	3647	0.40

Source: Own calculation

Table 12 Cooperant-Member ratio for the whole sample

No.of members	Members		Cooperants		C/M Ratio
	No of coops	Total members	No of coops	Total cooperants	
< 10	87	524	52	9057	0.45
10 - 50	89	1730	63	6992	0.47
50 - 100	18	1149	14	1642	0.38
> 100	16	4201	14	8025	0.41

Source: Own calculations

The average cooperant-member ratio represents the average individual cooperant-member ratios of each cooperative for each membership category. Again, the closer it is to 1 the more intensive the role of cooperants.

Another important dynamics can be read from information presented in tables 11 and 12 and it concerns the total number of members in cooperatives and the structure of cooperative sector concerning the membership size of cooperatives. From the Table 11, we can observe that only 9 cooperatives with less than 10 members were formed before 1995, while there are 78 cooperatives in the same membership-size category that were formed after 1995. It is clear that in post-Dayton period, cooperatives have opted for smaller membership sizes fully exploring the legal possibility to have a cooperative with less than ten members.

Not all cooperatives have cooperants. Out of these numbers, from the pre-1995 category, 7 cooperatives work with 284 cooperants. At the same time, out of 78 cooperatives with less than 10 members formed after 1995, 45 of them administer a total of 8773 cooperants. This yields average cooperative-member ratios of 0.6 and 0.44 respectively signifying that there is a misalignment between the ownership in a cooperative and practice of governance participation.

<sup>56</sup> Number of cooperatives which have cooperants.

Nevertheless, the evidence presented above is not conclusive as to whether pre-1995 or post-1995 cooperatives, or cooperatives of different membership sizes are more prone to outsourcing their business activity to their non-members and keeping the benefits arising from ownership rights among the members. However, the data reveal that out of 210 cases examined, in 108 cooperatives the number of cooperants is greater than the number of members. In the remaining 102 cooperatives, the members outnumber the cooperants.

When the entire sample of 210 cooperatives is taken into account, as presented in Table 12, the cooperant-member ratio reveals that most cooperative-like enterprises are those whose membership base ranges between 50 and 100 members. It is also clear from the table that the greatest number of cooperants is still associated with smaller cooperatives having less than 10 members or anywhere from 10 to 50 members.

While no conclusive views can be drawn from the previous tables regarding the cooperant-member ratio in specific categories of cooperatives, it can be said with certainty that the problem as such is overwhelmingly present and rather relevant for the cooperative sector in BiH as a whole, indicated clearly by unproportionate number of cooperants compared to the total number of cooperative members in the whole sample. If persistent it can have serious consequences for future understanding of cooperative identity especially having in mind that cooperatives are patron-centered enterprises with members considered main patrons.

Acknowledging the multilayered structure of the patron category, and keeping in mind the cooperant-member dynamics in BiH cooperatives, it is useful to differentiate between *beneficiaries* and *users* as two distinct categories of patrons in BiH who derive a different kind of utility from being associated with the same cooperative. In this particular context, I use a category of beneficiaries to imply a multitude of possible benefits that can be derived from using a cooperative (benefits related to opportunistic behavior included), while a category of users implies benefits that arise from use of cooperative only. Therefore, cooperative members are in this context classified as cooperative beneficiaries since they are the ones who not only use the cooperative for their own productive purposes and thus gain from it but get to have the benefits of decision making rights and a full control over cooperative activities including the patronage refunds. Cooperants, on the other hand, are seen here as cooperative users and the benefit they derive from a cooperative is of commercial nature only and it stops once the goods are handed over to the cooperative in exchange for the price.

The fact that cooperants form such an important element in cooperative structures in BiH is not to be taken lightly. As it was argued before, in a context of institutional insecurity and overall slow structural change in BiH agricultural sector, what on a surface may appear as a technical issue having to do with outsourcing part of cooperative activities to non-members can in fact prove to be an important factor that shapes how cooperative perceives of its own objectives and

nature and also how it is perceived by members, non-members and wider community in pursuing those objectives. The following table proposes how different aspects of cooperative objectives are pursued in cooperatives which have only members, those in which members outnumber cooperants and finally, those in which cooperants outnumber members signalling thus that cooperative identity is a multi-stakeholder construct that at the same time reflects the prevalent cooperative structure as well as processes practiced within the structure itself.

The observations presented in the table below are deduced from interviews with cooperative directors and representatives of cooperative associations and serve to explain the ways in which cooperative structures and processes if not understood and practiced properly can derogate the cooperative identity in the long run.

**Table 13 Cooperative identity as a complex, multi-stakeholder construct**

Coop with dominance of		Members	Members > Non-Members	Members < Non-Members
What are primary objectives?	<i>Economic</i>	Pecuniary benefits to members	Pecuniary benefits to both members and non-members; greater for members because of their usage of coop	Pecuniary benefits to both groups; noticeable inequality in their distribution among the groups favoring members over non-members
	<i>Social/Communal</i>	1. Nonexistent - perceived as too costly; 2. Unintentionally emerging among members; 3. Deliberately fostered through promoting participation and community involvement as a form of long term social investment.	1. Nonexistent - perceived as too costly; 2. Moderately existent but aimed at members only; 3. Deliberately aimed at members and non-members alike focusing on turning non-members into members	1. Nonexistent - perceived as too costly; 2. Moderately existent among members;
How are objectives attained?	<i>Ownership and Governance</i>	Democratic participation; Private ownership of own resources; Some common(ly managed) resources	Ownership of resources and governance in hands of members	Ownership among members; governance structure usually rests on strong directors with other democratic means only rarely employed
	<i>Risk allocation</i>	Shared by members	Risk shared between members and non-members with greater risks born by members	Unequally dispersed among members and non-members
Consequences for coop identity	<i>As perceived by members</i>	Genuine coop	Genuine coop with uses non-members in its productive activities in order to cut costs of production and attain greater levels of profitability for its members	Coop serves the purpose of awarding greater financial gains to members than they would be able to attain individually
	<i>As perceived by non-members</i>	Not relevant	Genuine coop that provides them with either only pecuniary benefits or a mix of pecuniary and non-pecuniary benefits with prospects for attaining membership if desired	Coop perceived as a middleman in the market usually paying the lowest price possible; sometimes seen as overexploitative
	<i>As perceived by community</i>	Depending on the intensity with which coop's social role is being promoted may range from perceiving it as self-oriented coop or community oriented coop	Genuine coop that engages both members and non-members in its productive activities; useful to the community especially if it creates more social cohesion among the participating parties	Coop relevant in as much as it contributes to the creation of economic activity among members and non-members but not perceived as being much different from conventional firms

Source: Own elaboration

In line with numerous scholarly contributions on cooperative objectives, they are here classified into economic and social but what matters more than their classification is how they are attained through structures of ownership, governance and a dimension of risk allocation. Due to a number of internal and external insecurities that surround cooperatives in BiH, a matter of risk allocation becomes crucial in the longevity of the cooperative enterprise. When cooperants outnumber members, the vast portion of risks associated with productive activities are outsourced to informal and loose structures composed of many individual cooperants. When this is done, cooperative can no longer be perceived as risk sharing and cost-reducing

mechanism but what it often becomes is a means for members to safeguard themselves against unpredictable agricultural market. That way the risk is mainly unequally distribution and in a manner that favors members over cooperants who bear a portion of risk unproportionate to the benefits they derive from the cooperative. Additionally, cooperative structures thus end up being reduced to performing purely commercial function both for members and cooperants.

Additional explanations that reflect on the generalist nature of BiH cooperatives and absence of internal regulatory mechanisms will be provided in the section that follows for hypotheses two and three are seen as related and complementary.

### The importance of power structure

In addition to variable describing the cooperant-member dynamics, the variable for the power structure in cooperatives is perhaps the next most interesting aspect of BiH cooperative sector to study as it highlights the most interesting and contested aspect of cooperative enterprises: its governance structure and the position of power in decision-making. When tested for correlation, the variables cooperant-member ratio and consolidated power structure were shown to be positively correlated however the correlation was not very strong (0.224).

In the section dealing with variables and hypotheses, in relation to the participation it was hypothesized that cooperatives that have meaningful participatory structure in place will show better economic efficiency. The results of the analysis carried out on a sample of BiH cooperatives, however, point to the contrary and they reveal that cooperatives with very consolidated power structure tend to have the best performance. A number of reasons can explain why consolidated power structures appear to be superior to more engaging structures and processes in producing economic gain for cooperative patrons in this particular context.

To begin with, it is necessary once again to highlight the meaning of 'power structure' in this Chapter. The power structure here in fact refers to the locus and manner of decision making, or in other words: who holds the power to decide on short and long term issues; how is this power practiced with respect to other structural actors in a cooperative; and for what purposes. The direct implication of the results obtained suggests that cooperatives in which director or a very small group of his trustees take important decisions without going into consultation with members tend to perform better. The decisions referred to here include both short and long term business matters including production related issues as well as expansion of membership. Effective practice of economic democracy does not take part in such structures. What internal and external conditions explain the functionality of such decision-making practices in BiH cooperatives?

Historically, there has been very little practical application of economic democracy among BiH farmers. It is possible that more consolidated power structure therefore is also associated



with more efficient decision-making process which is at the same time less costly compared to involving the entire membership in the decision-making process. In the sample studied, such cooperatives are usually not very open to new membership or have very high restrictions on membership expansion – all tendencies pointing to a partial, but rather pragmatic, understanding of cooperatives' purpose given the circumstances in the institutional environment.

There were five categories of power structure identified in the sample, namely: very consolidated, consolidated, normal, diffuse and very diffuse.

The cooperatives that are classified as having a very consolidated power structure are the ones in which the personality of a director predominates in terms of strategic and especially everyday operational decision-making. The most frequently visible aspect of decision-making power in a cooperative refers to an exclusive right of its director to make many important decisions without feeling the obligation to consult with the wider membership. Here the power refers to directors' and/or managers' ability to control decision-making processes and their outcomes. The overwhelming numbers of cooperants in some cooperatives with no right to fully participate in the decision-making processes of their cooperative may in fact help consolidate the power in the hands of only few cooperative members. Those cooperatives make up around 22% of the sample.

Cooperatives classified as consolidated are those in which apart from a director there is a small management group which is often an ad hoc group of people close to the director who together with him decide on important matters for a cooperative. In the sample studied, there are around 19.5% of such cooperatives. Both in the case of consolidated and very consolidated cooperatives directors interviewed seem to have been fully aware that in some instances the basic cooperative rights to being informed and being part of decision-making process were breached, but such behaviour was justified on the grounds that "having a firm hand in a cooperative is sometimes the only way to do business properly."<sup>57</sup>

Normal cooperatives can be said to be more or less respectful of the collective decision-making procedure as well as cooperatives' inclusive approach to governance. They hold regular meetings and are generally involved in decision-making procedures including financial matters and approval of applications for membership. These make up the majority of the sample.

Cooperatives with diffused and very diffused power structure are those that do not appear to have a strong and decisive personality for a director or either make decisions within a loose and often informal circle of people not making a full use of cooperative bodies. Instead,

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<sup>57</sup> Interview with a cooperative director, August 2011. It was also highlighted that members and cooperants often did not even mind this style of leadership and only cared about director's honesty and about getting their share of income on time. In some cooperatives that were labelled 'very consolidated' it was brought up during the interview that the power vested in the director went so far that he was entitled to decide alone whether new members should be allowed to join a cooperative or not.

cooperative bodies are usually treated as a nominal legal requirement and information is provided upon request rather than during the regular meetings of cooperative members.

Table 14 Cooperative power structure: an overview of the sample

Power structure	Freq.	Percent	Cum.
Very Consolidated	46	21.9	21.9
Consolidated	41	19.52	41.43
Normal	96	45.71	87.14
Diffused	21	10	97.14
Very Diffused	6	2.86	100
<b>Total</b>	<b>210</b>	<b>100</b>	

Source: Own calculation

A total participation approach as argued by Novkovic et al. (2012) is what makes cooperatives so different from conventional firms. The ownership and control rights in cooperatives are placed in the hands of members who through democratic procedures get to check the work of cooperative management, be it internally elected or externally hired, and more importantly get to define the development trajectory of their cooperative.

In an alarmingly large number of cooperatives in BiH there seems to be very little of the cooperative democracy. Now, this may well be the effect of the stigma that has been for decades attached to cooperative enterprise. But also, it may point to certain governance aspects common to all cooperatives in unstable institutional environments. To be more specific, this can be related to the discussion on cooperative objectives as presented at the beginning of the chapter. When the institutional environment is characterized by systemic deficiencies, and society as a whole lacks interpersonal and ‘perston to institution’ trust, cooperatives are seen as short term solutions created to fix visible economic problems and create immediate rather than long term benefits.

In such circumsstances, little attention is paid to procedural fairness because it was never intended as cooperative goal. Instead, cooperatives end up being registered as legal entities and are effectively run as conventional firms.

On the surface, the situation in which important decision-making powers end up in hands of one or few individuals and go basically unchecked by any other cooperative body may appear as an instance of opportunistic behaviour on part of certain directors made possible because of unclear legal environment and conflicting laws in cooperative sector. However, one needs to be careful in attaching such a label to cooperatives in which a director or his trustees emerge as main decision makers. The reality of cooperative sector in BiH also reveals the chronic lack of demand for the change of this behaviour. A lot of cooperative members are comfortable with not getting involved in decision-making process perceiving the processes themselves as unnecessary and costly. And while sometimes, directors who emerge into decision-making

position may be well-meaning and benevolent, there are also situations in which opportunistically motivated individuals abuse the lack of willingness on part of membership to initiate the change of such behavioural trends. In case the latter happens, the stigma already attached to cooperative enterprises becomes confirmed in the eyes of those who do not believe in the long term transformative power of cooperative enterprises.

There are two ways to view the results. The straightforward manner suggests that the higher economic efficiency is associated to more consolidated power structures in cooperative decision-making. However, a less straightforward way of interpreting the results would point us in the direction of questioning the quality of the coordination mechanism used in the cooperatives studied. If, as results point out, more consolidated power structure is associated with better economic efficiency, this need not mean that the participatory decision-making as such necessarily produces lower levels of economic efficiency. Instead, the results presented here point to the fact that there may be something wrong with the way participatory decision-making is being understood and practiced in the BiH cooperative sector. Indeed, before dismissing cooperative participatory governance mechanisms on a conceptual level one needs to examine the conditions in which decisions are being made in the BiH cooperative sector, and those may refer to the general conditions in the agricultural market, the characteristics of cooperatives as such, as well as the nature of cooperative culture in BiH.

In the period following the independence of BiH, and especially in the aftermath of the 1995 war, the markets in BiH have been subjected to an instantaneous and fast liberalization. The privatization process turned previously publicly owned enterprises into privately owned ones almost over night. The change in business attitudes did not follow suit at the same pace. Agricultural cooperatives were caught unprepared to respond to sudden change in the institutional environment. Their previous reliance on state structures for production decisions has left them unable to compete in the open market structures. Furthermore, proper participatory decision-making, in addition to being relatively unknown to small farmers, was also considered a luxury given the circumstances. Such conditions yielded individuals who took charge of decision-making rather than structures to consolidate cooperative processes over time.

In addition to swift and sudden changes in the institutional environment, it is also useful to recall that the cooperatives in this sample are mainly general cooperatives which invest no capital in specialization or any other kind of entrepreneurial innovation. Because they are not highly specialized, their membership comes from different subsectors and has very divergent interest which renders participatory decision-making and coordination of activities rather costly and it therefore ends up being avoided in order to achieve as much of economic benefit as possible. Moving towards more specialized cooperatives would also increase the stake for

members, including the asset specificity, and they would likely be more interested in participating in decision-making processes because of the generally higher risks. In the present situation, since the risk is also dispersed between members and cooperants, the concentrated power structure resonates well with cooperatives understood as instrumental in fulfilling members' pecuniary objectives.

It has been shown that the largest and most efficient cooperatives focus on producing only one commodity. Such cooperatives have worked out a coordination mechanism that does not trade off democratic participation for economic efficiency. However, this is not the case in the BiH cooperative sector in which the cooperative model is used not just as the transaction costs reducing mechanism but also as a vehicle of political empowerment for cooperative leaders who often, being able 'to control' cooperative decisions, appear to be interesting partners to local political elite.

Although on the surface these results may appear as supporting the view that efficiency and democracy do not work well in cooperative structures, this indeed is not the only interpretation. In fact, given the context and history of cooperative movement in BiH, it is safe to argue that simply adopting the interpretation that entails a mandatory trade off between democratic practices and cooperative efficiency would amount to oversimplification of both cooperative model and its institutional context in BiH. And both need to be analysed in order to account for the importance of highly consolidated power structures in explaining economic performance of cooperatives.

In light of the discussion at the beginning of the chapter that focused on factors necessary for a cooperative to transcend its legal status and move towards becoming a strategic long term alliance of members, it is possible to outline three groups of conditions that first explain the importance of consolidated power structures for cooperative efficiency in BiH and second, outline conditions that are to be fulfilled if democratic decision-making is to meet efficiency in a cooperative model. These conditions are economic, governance related conditions and conditions reflective of functional cooperative culture.

Economic conditions presuppose the existence of clear economic benefits that make cooperative an enterprise of choice rather than despair. There is a tendency in less developed and particularly post-soviet countries to look down at the cooperative model as an organizational solution that perhaps keeps the rural poverty levels as they are without expecting the model itself to empower the members enough and set them on the path of rural development. This has certainly been the case with BiH agricultural cooperatives. The perception public authorities hold of cooperatives can be summed up along the following lines: Cooperatives do not make matters worse, but they certainly do not make them better. As currently practiced in BiH agricultural market, the cooperative model lacks clarity in economic

incentives that would motivate members to take greater control of internal processes and decisions in cooperatives. One of the most important functions of agricultural cooperatives is to provide more long term security to many individual farmers, to help them gain easier access to capital and to strengthen their market position by affording them favourable prices compared to non-members. This preferential treatment of members is what essentially motivates individual farmers to form and join cooperatives.

As explained before, agricultural cooperatives in BiH hardly make any difference between members and non-members in terms of economic gains, except for the right of members to patronage refund. Other than that, in every day dealings members have no special advantage over non-members. This lack of differentiation makes participation in cooperatives appear even costlier than it would actually be because members see no direct benefit arising from it. Furthermore, most cooperatives examined are focused exclusively on the commercial activities of their members and devote little resources to education and other activities that could in the long run result in personal development of members. Since cooperatives are generally focused on pursuing the economic gains of their members, to them devoting time and other resources to introducing, practicing and monitoring participation of members is rendered costly and not in line with their primary objective. Having a consolidated power structure, thus cutting down on participation related costs including additional monitoring, is in fact a cost effective strategy that cooperatives employ in order to achieve as much economic gain as possible.

The second group of conditions the fulfilment of which is necessary if the cooperative model is to fully implement cooperative business philosophy relates to ownership and governance matters. While the General Law on cooperatives in BiH describes who has a legal right to be a cooperative member it is silent as to the (physical) resources, other than membership fee, that a prospective member must have in order to be meaningfully engaged in cooperative. According to this Law the legal minimum of members/individuals necessary for establishment of a cooperative is five. This lack of legal clarity allowed for the emergence of the so called 'family cooperatives' in which usually the male head is the only legal owner of resources, most often of land, and other members of nucleus family help out with productive on-farm activities but own no resources of their own, other than their labor. The fact that essentially multistakholder cooperatives are allowed to be registered as agricultural cooperatives has repercussions on how the entire membership is governed and managed. Such 'cooperatives' are often closed to new members and are characterized by high levels of internal trust, which is natural since the immediate environment is that of a family, but at the same time exhibit high levels of distrust towards anyone outside of the family circle. Changing conditions and requirements for cooperative membership, including the processes through which cooperative management gets

elected to their positions could contribute greatly to distilling cooperatives with real potential from private family farms that simply use the cooperative name.<sup>58</sup>

The details of legal ambiguities surrounding cooperative enterprise were discussed in Chapter V, but suffice it to note here that a great deal of important decisions that pertain to principles of cooperative governance are left to cooperatives to decide upon internally. For instance, the Law advises that the director be elected directly by members through the democratic 'one member, one vote' principle. However, it also leaves a possibility to cooperatives to decide internally if they wish to elect the director in any other way and through any other body within the cooperative. This leaves ample space for manipulation in terms of exploiting internal cooperative structures. Overall, leaving too many matters that pertain to core cooperative principles to be decided upon within individual cooperatives is rather risky given the history of cooperative movement in the countries of former Yugoslavia.

Not only does this make it possible for cooperatives to disregard important aspects of cooperative way of doing business but it makes it increasingly difficult to monitor the implementation of cooperative principles since virtually every cooperative has been given the right to interpret them.

Lastly, the conditions that have to do with understanding and practicing cooperative culture are perhaps the hardest to build as they require cooperative members to be able to see the long term purpose of their cooperative enterprise and to prioritize it over short term economic gains. It could be argued that changes in governance structures and incentive schemes cannot be made until there is at least a minimum of cooperative culture and trust among cooperative members.

### Social property: Not quite done with the past

As regards ill-defined property rights it was hypothesized that lack of clarity in how property rights are assigned is associated with lower levels of economic efficiency. This hypothesis was confirmed by empirical results. There is significant and negative relationship between the presence of social property in cooperatives, i.e. property with unclear title, with their economic efficiency.

As stipulated earlier, cooperatives that have social property or property with otherwise unresolved legal status have a bulk of additional costs related to proving the ownership over the contested property. In addition to new costs, there is also a limitation to cooperatives' ability to borrow capital in the market since property with unresolved status cannot be used as collateral. All of these factors certainly have the potential to drive down the efficiency levels of

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<sup>58</sup> The analysis of the administrative and financial requirements for setting up a business reveal that it is simpler and less costly to set up a cooperative than a privately owned business. Additionally, the market exit conditions favour cooperatives as well. It is possible that many individuals consciously decide to register a cooperative exploiting the low legal minimum number of persons required to set up a cooperative in order to avoid costs associated with setting up a private business.

cooperatives. For example, cooperatives can decide not to carry out investment projects when the prospects of appropriation of future returns are uncertain due to the misfit of the institutional frame.

The reason why social property is much discussed in relation to cooperative movement in almost all post-Yugoslav countries and especially BiH, can be traced back to Article 4 of the Constitutional Law on basis of social and political system of Federal Peoples' Republic of Yugoslavia and its federal authorities from 1953 (Pajkić, 2014). This 1953 Constitutional Law proclaimed that the power in Yugoslavia rests with its working people and declared the social ownership over the means of production.<sup>59</sup>

In practice this meant that cooperative property also became a part of social property and thus lost the continuity of its identity. After the break-up of the Yugoslavia each of its constituent republics went on to resolve this issue mainly by returning the social property that was of cooperative origin to their original owners or, if they ceased to exist to cooperatives that inherited their legal personality or alternatively to cooperative associations. The 2003 General Law on cooperatives in BiH attempted a similar solution. However, due to inconsistencies of laws applied throughout the country much of social property remained with still unresolved status.

Social property, i.e. collectively owned property in and of itself produces less efficient behaviour than private property. Such property is open to overexploitation and is quite inviting to all sorts of opportunistic behaviour from cooperative members as well as public authorities.

In the sample studied, 37 cooperatives reported to have such property amounting to 17.62% of the total sample.

Table 15 Social property in cooperatives

Social property	Freq.	Percent	Cum.
<b>Absence</b>	173	82.38	82.38
<b>Presence</b>	37	17.62	100
<b>Total</b>	210	100	

Source: Own calculation

Cooperatives that do have social property reported their economic activities and especially the growth and expansion of their cooperatives to be constrained by its presence. Out of 37 cooperatives that have reported presence of social property majority of them, 19 altogether, fall in the group of cooperatives with membership ranging from 10 to 50. Altogether, the number of members and cooperant in affected cooperatives is 1647 and 8115 respectively.

<sup>59</sup> Former Yugoslavia's Archives available at [http://www.arhivyu.gov.rs/active/sr-latin/home/glavna\\_navigacija/leksikon\\_jugoslavije/konstitutivni\\_akti\\_jugoslavije/ustavni\\_zakon\\_1953.html](http://www.arhivyu.gov.rs/active/sr-latin/home/glavna_navigacija/leksikon_jugoslavije/konstitutivni_akti_jugoslavije/ustavni_zakon_1953.html).

Table 16 Social property, members and cooperants

	Members		Cooperants	
	No of coops	Total members	No of coops	Total cooperants
< 10	9	51	7	1245
10 - 50	19	416	14	1353
50 - 100	3	191	2	680
> 100	6	989	6	4837

Source: Own calculation

Recently, RS authorities enacted the law on agricultural cooperatives which in complete contradiction to the valid state level Law declared that property in cooperatives whose ownership status is still not clear is to be appropriated by local authorities and may be leased back to cooperatives that used it at a favourable rate. Proclaiming this property part of the state property is, according to some cooperative directors, a way of renationalizing valuable property so that it could be privatized at the will of local politicians. This issue will be taken up in greater detail in the next chapter.

## Poultry

Interestingly enough, of all sub-sectors included in the analysis the only one that appeared to be statistically significant in explaining economic efficiency in cooperatives was the sub-sector of poultry. One way to explain this is to look into the kind of labour that is associated with each of the sub-sectors. Perhaps the high degree of routine kind of work in poultry cooperatives, lower levels of goods perishability compared to fruits and vegetables and dairy sub-sectors, explains why this sub-sector shows more economic efficiency than others. Since I do not have the data on costs of individual farmers I cannot tell whether the higher efficiency is due to the fact that overall costs are higher or if, instead, such cooperatives are indeed more efficient compared to other cooperatives. One observation that stems from analyzing the sample points to the fact that poultry cooperatives were mainly focused on poultry alone, while other cooperatives almost as a rule had a mix of various sectors and it was therefore difficult to distil which sector takes the priority in focus.



## Understanding cooperative governance: the case of small size cooperatives

One of the most contentious issues in Bosnian cooperative sector is the difficulty associated with distinguishing genuine from non-genuine cooperatives. Although this is a problem elsewhere as well, the very special dimension to the whole issue in BiH is created by rather vague legislative framework that fails to regulate different types of cooperatives. As explained earlier, the emergence of the so called 'family cooperatives' highlights legal loopholes that allow what is essentially a multistakeholder cooperative to be registered as agricultural one. One of the reasons this may be happening is due to administratively lengthier and financially costlier procedures associated with starting a privately owned enterprise as opposed to a cooperative enterprise. Reasons for their presence aside, the consequences of their existence extend far beyond avoiding the initial set up costs.

While their membership usually includes only close family members, they operate with considerable numbers of contracted non-member suppliers who carry out the bulk of the productive process but reap very limited benefits from being associated with such enterprises. The sample used for this analysis does not provide enough detailed information on the ownership of resources brought into the cooperative to know for sure which cooperatives from the sample can be classified strictly as family cooperatives and which cannot. However, the number of members was used as a proxy for what may be family cooperatives in the sample and it was assumed that such enterprises would most certainly have the minimum number of members in order to fulfil the legal requirement. Since legal requirements differ across the country depending on the law in place and range from 5 to 10 members, the threshold of 10 members was taken to represent the maximum number of members in such enterprises. In order to acknowledge their presence and to check if it somehow changes the results of the analysis presented earlier two approaches were taken:

a) Extending the original model: a dummy variable representing what I thought could be a family cooperative in the sample was introduced into the original model. No signs of coefficients changed and the variable introduced signified a positive relation between the presence of family cooperatives and cooperative efficiency;

b) Focusing on the small membership cooperatives as a separate category: cooperatives with less than 10 members were classified into three categories: those that have ten or less members regardless of whether they work with cooperants or not (100 cooperatives in this category); those that have ten or less members and work with cooperants regardless of their numbers (57 cooperatives in this category); and those that have ten or less members and work with 50 or more cooperants (23 cooperatives in this category). Following this, a model was run for each category separately. No changes in the signs of coefficients were observed in all cases considered, however some interesting insights emerged as regards the significance of variables

reflecting the power structure and presence of social property. One variable that was consistently significant and positively related to cooperative efficiency was the cooperant-member ratio.

With regards to power structure, it was evident that it was less significant for the first category of small cooperatives and its significance grew as the number of cooperants associated with cooperatives increased. There are two implications of this. Firstly, obviously the small membership sizes do not require a strict concentration of power but the governance mechanism itself may spontaneously involve all cooperative members in one capacity or another into various stages of decision-making. When maximum number of members is ten they are all likely to be participating in cooperative internal structures in some capacity. So this makes the inclusive decision-making a more natural governance option.

Secondly, that the significance of the consolidated power structure grew together with numbers of cooperants associated with the cooperative shows that consolidated power structure is aimed mostly to manage the cooperants rather than members themselves. Since cooperants have purely commercial relation to their cooperatives, a more hierarchical governance structure is a way of safeguarding and maintaining economic efficiency. The repeated significance and positive relation to cooperative efficiency of cooperants to member ratio serve to underline this point as well. This is to say that the concentration of power is necessary to keep a certain level of productivity and efficiency. While this may be contrary to the assumed preference to horizontal as opposed to hierarchical relations in cooperatives, the results must be viewed in the context of the cooperative sector as a whole and especially in relation to what are thought to be the prevailing patrons' objectives in cooperatives. This perhaps is the necessary starting point for cooperatives in a transitional and post-conflict setting of BiH, an important first step of ensuring basic economic efficiency before more inclusive governance structure is built over this basis. In order to achieve that, cooperatives would have to gradually decrease their hierarchical relation to cooperants and design the ways to include them in their membership.

Furthremore, consolidated power structure and cooperant to member ratio are positively correlated which in itself is insightful of the nature of governance mechanism that is in place when there exist a hierarchical relation between two groups of patrons. In other words, decreasing the number of cooperants either through eliminating dependence on them or including them in the membership structure implies that a more inclusive and participatory power structure could also produce reasonable efficiency results.

Creating enlarged governance structure, insisting more on specialization of cooperatives, and dealing with multistakeholdership could be a good way of reducing currently present hierarchical and strictly commercial relations between cooperative members and cooperants.

Since cooperatives are enterprises that aim to increase their members' welfare and favour inclusive governance structures to the hierarchical ones, focusing on reforming the membership including the necessary changes in incentivizing membership could be a good way of ensuring that both economic efficiency and social capital are reached and built over time.

## Conclusion

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This chapter focused on explaining organizational and institutional determinants of cooperative efficiency for a sample of 210 agricultural cooperatives in BiH. The specificities of cooperative enterprise in terms of ownership and governance dictate the ways in which cooperative performance and its measurements will be conceptualized. With that in mind, I argued that when assessing cooperative efficiency one needs to take into account at least two issues, namely: the very purpose with which cooperatives are set up in the first place and members' perception of their cooperative's future. Following that argument, I suggested that cooperatives can end up being one of two things: simply a legal entity giving a form to fulfilment of members' pecuniary interests or a long term strategic alliance of members contributing to their stronger economic position but also building the social capital ties among them.

The main findings can be summarized in the following manner: cooperative size measured in terms of its total assets has a positive relation to economic efficiency; cooperatives in which cooperant to member ratio is higher show higher levels of economic efficiency; cooperatives characterized with highly consolidated power structure perform better; the presence of social property in cooperatives has a negative impact on their economic efficiency; cooperatives in poultry sub-sector show better economic efficiency than cooperatives in other sub-sectors.

Such findings can have significant policy implications. First of all, consistent with North's (1994) argument which highlights the importance of external environment not only for a choice of organizational form but also for its efficiency, it was found that Bosnia's insecure institutional environment, unclear economic incentives attached to cooperative membership, unclear delegation of power in cooperatives, and a general lack of trust between economic actors and towards public institutions discourages farmers from creating long-term cooperative structures. Instead, they opt to focus on gaining whatever minimum income they can through existing cooperatives.

Aside from the general observation that context has a bearing upon efficiency, two matters stand out in particular as important factors explaining the success or lack thereof in this sample: existing property right structures and cooperative identity crisis. Additionally, the results highlight that one of the major questions stemming from the NIE scholarship that concerns the purpose of the firm can be answered in a number of ways, of which transaction cost minimizing function is just one, and perhaps more importantly that the purpose is molded by the political

and economic context as well as the evolutionary path of the cooperative model. While the NIE scholarship has treated the cooperatives as an institutional response to high transaction costs associated with acting alone on the market, there is much to be told about the ways in which cooperative specific ownership and governance structures reduce the transaction costs and especially about the distribution of the resulting benefits among cooperative patrons. Observing the ability of various dimensions of cooperative ownership and governance structures to affect the fluctuations in the transaction cost is especially interesting in transition countries where the role of the institutional environment cannot be taken for granted.

Indeed, the cooperative should serve as a long term security net to its members, the one that they build and strengthen by being actively involved in all of its structures and processes. Such levels of commitment are difficult to achieve in short or even medium term in societies that have had a history of violent conflict in addition to turbulent changes in political and economic systems. Building trust takes time and requires opportunities for recurrent actions. It also requires a stable and supporting institutional environment, both of which are currently missing in BiH society. It is precisely lack of trust among members and between members and the institutional environment that can aid in explaining why cooperatives in BiH appear to be treated mainly as an instrument for short term economic gain.

Lastly, building participatory governance structures and internal mechanisms that oversee the regularity of their functioning requires a direct and long term commitment, an investment of its own kind both by the cooperative and public sector. To ensure a wide member participation in cooperative structures management needs to carry out a lot of coordination work among potentially different interest groups and these efforts require a view of cooperative as a long term strategic alliance.

As for the implications specific to the BiH cooperative sector, promoting the true idea of cooperation in which the finest characteristics of equality and economic democracy are to be found would contribute to creating a more equitable distribution of financial gains among BiH rural population. While a better definition of property rights is required from adequate legislation, cooperative governance comes under closer scrutiny as the crucial dimension that is potentially able to guarantee participation and inclusion of various stakeholders without lowering efficiency and inflating organizational costs. Creating a more stable institutional environment would then enable farmers to move beyond simply using cooperatives for their immediate pecuniary gain towards conceiving of them as catalysts of social change and rural economic prosperity. However, this cannot happen without clearly articulated economic incentives for members, reform of governance and decision-making procedures and serious investment in building interpersonal and institutional trust in cooperative sector.

# Chapter VII

## Property rights in BiH agricultural cooperatives: In search of institutional clarity

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Property rights are institutions that provide for more certainty in our behavior and therefore affect outcomes such as economic performance and efficiency.  
(Douglass North, *Institutions and Economic Performance*, 1990)

### Introduction

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This Chapter focuses on analyzing one of the fundamental rights of individuals and peoples, the right to own property and to benefit from that right. As noted by Demsetz (1967), a transaction in a market place is nothing more than an exchange of property rights, and along with them of expectations attached to the value of rights being exchanged. Property rights structures are thus instrumental in shaping incentives for resource allocation. As such they condition the risk propensity of market actors and affect the level of trust among them.

In their seminal 1973 article on the property right paradigm, Alchian and Demsetz suggest that the three questions that had so far (mis)guided the mainstream economics, namely “what goods are to be produced? How are these goods to be produced? Who is to get what is produced?” be replaced by the following three: “What is the structure of property rights in a society at some point of time? What consequences for social interaction flow from a particular structure of property rights? How has this property right structure come into being?” (1973: 16-17). They justify this suggestion on the account of a societal inability to correctly and in detail predict the answers to the abovementioned questions. They further argue that the relations in a society are burdened by the conflict over scarce resources and each society decides upon a mix of conflict resolution devices derived mainly from various techniques, rules, and customs including market and property right structures.

In terms of understanding the structure of rights related to a particular property, Alchian and Demsetz highlight several fundamental features of ownership. Firstly, ownership may be shared among many parties, i.e. ownership has a divisible character. Secondly, and perhaps most importantly, they stress that “it is not *the* resource itself which is owned; it is a bundle, or a portion, of rights to *use* a resource that is owned” (1973:17). So, when the market transaction

takes place, it essentially boils down to an exchange in property rights, where “the value of the rights determines the value of what is exchanged” (Demsetz, 1967:347).

More specifically, property rights can be defined as legally protected rights of an owner or owners to generate income by using a good or asset, selling or renting it to a third party thereby temporarily or permanently transferring the ownership over a good or asset (Besley and Ghatak, 2009). Consequently, every property right structure comes with a specific distribution of benefits that arises out of the ownership rights underpinning the structure itself.

The ability to exercise the right of ownership includes the ability to enter into various kinds of contractual relations with other parties specifically referring to the way in which a good or asset can be used (by mortgaging, for example). In establishing the contractual relations among different parties the presence of mutual trust is paramount. People must be able to trust that their right to property is protected and easily enforceable. Ownership structures therefore require a sufficiently well defined legal framework in order to produce a desired benefit for the contracting parties and ultimately result in increased economic activity. It is thus clear that the degree to which property rights are legally defined, protected, and facilitated, not only affects economic development but also conditions it.

Therefore, given the importance of property rights and clear ownership structures to overall economic activity, two additional issues are worth exploring: the channels through which property right structures affect the level of economic activity and the determinants of a particular property right structure (Besley and Ghatak, 2009).

By looking into the fundamental channels through which property right structures affect the level and intensity of economic activity in the BiH cooperative sector, I will hypothesize that absence of clear titles for social property undermines the ability of agricultural cooperatives to achieve better levels of development. Any solution regarding the status of social property that falls short from necessary clarity is bound to increase and even multiply the systemic risks already present in cooperative sector of BiH.

Keeping up with the aim of this chapter the following research questions were asked: what is the current structure of property rights in BiH cooperative sector? Are problems with property right structures typical of cooperative sector or they are found elsewhere as well? What are the most common channels through which ill-defined rights over property affect economic life of cooperatives? What factors help keep the current structure of property rights in place?

Following the conceptual and theoretical analysis of the institution of property rights, the chapter will report the findings on the effect of ill-defined property rights structures on a number of selected BiH agricultural cooperatives.

## Property rights paradigm

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### Property rights formation and structure

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One of the most prominent works that gives a detail account on property rights formation is Libecap's (1989) study on the way in which property right structures evolved in the four natural resource industries in the USA. Libecap argues that property right structures affect economic performance in at least two fundamental ways. Firstly, they structure incentives for economic behavior by assigning who bears the benefits arising out of ownership rights. And secondly, by giving ownership rights to a party and therefore decision-rights over a piece of property, they also affect the distribution of economic power. Attempting to explain the interplay between the political elites' power to enforce a particular property rights structure and the strength of those affected to bargain their way out of the unfavorable arrangement, Libecap maintains that property rights are above all social institutions that reflect the dynamic relations in a society and can be either formal or customary but nevertheless have the power to formulate the incentives for economic behavior. Thus, they ultimately affect the expectations of the actors and therefore their economic performance.

Property rights matter not just for the functionality of a system as a whole but because they have a very clear impact on individual decision-making as well. In line with that, Furubotn and Pejovich contend that „the set of various property rights held over resources enters into the utility function of the decision-maker“ (1972:1139).

While different property right structures have diverse economic consequences they are to a great degree an outcome of political processes. Libecap confirms this and writes: „Property rights institutions are determined through the political process, involving either negotiations among immediate group members or lobbying activities at higher levels of government. The political process of defining and enforcing property rights can be divisive because of the distributional implications of different property allocations.“ (1989:4).

This means that the impact of property right structures on economic systems is at the same time collective, through political elites and their power to enforce a specific rights arrangement as suggested by Libecap, but also this impact runs at the level of the individual's utility function as proposed by Furubotn and Pejovich. These are the channels through which the presence or absence of clearly defined property right structures most commonly affect the level of economic activity.

A crucial question regarding the property right structures concerns their evolution. How do certain structures come to be? What are their immediate and most fundamental sources? Apart from political processes that shape the formation and enforcement of property right structures, Libecap (1989) argues that the past legal precedents have a role to play in how property right

structures come to be and adjust to new economic realities. This is suggestive of a presence of path dependency mechanisms in the way how property right structures and accompanying benefits are conceived of in a society. The following paragraph gives a more specific account of the matter:

„If the political and economic systems are reasonably open to new entrants and there is a history of routine adjustments in property rights, then institutional change to meet specific economic problems is more likely. On the other hand, in less open societies where the status quo has been maintained by influential parties, new external market conditions will not bring the same expectations for institutional change“ (Libecap, 1989:6)

Property right structures are fundamentally related to externalities, that is to beneficial or harmful consequences of certain economic actions. Indeed, having efficient property right structure means being able to internalize the effects of externalities (Demsetz, 1967). The basic assumption of the property rights theory as presented in the writings of its classical scholars is that assigning property rights is an essential element that conditions the efficiency with which that good can be put to use. The efficiency of using the good decreases or disappears altogether if the right is not clearly assigned or if it is disputed among those who claim the right. There are three features of property right structures that are essential in this regard, namely: universality – all resources should have their owner; exclusivity – the owner has a right to exclude others from using the resource; transferability – to allow for resources to move from a less productive user to a more productive one.

At the very heart of the property rights debate is the relation human actors have to resources that are part of the surrounding system. Being part of the system of institutions, property rights structures affect various aspects of life, including political, economic, social, and cultural (Hanna et al., 1996). Within this complex network of relations from actor to resource, the most commonly recognized forms of ownership come in three categories, namely private, public and communal. However, when it comes to rights associated with the ownership itself, Schlager and Ostrom (1992: 250-252) suggest various bundles of rights associated with various positions one may have in relation to a resource. So, they contend that one may be an owner, proprietor, claimant, or an authorized user of property and in accordance with the position held has either access and withdrawal rights, management, exclusion and/or alienation rights.

Clearly, only the owner of the right can exercise access and withdrawal, management, exclusion and alienation. These distinctions are important inasmuch as they point to the fact that different parties such as proprietor, claimant and authorized user may have different interest in pursuing a specific right over a number of resource's dimensions.



The following section will look into how property right structures align with cooperative organizational form given the internal ownership specificities of cooperative enterprise.

## Property rights and cooperatives

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Can institutions in which users and owners are the same group of people exist and survive in a world which thrives on separating ownership from usership? Can collective action institutions such as cooperatives survive in a society which is increasingly individualistic? In the view of Fulton, these questions are related to how one perceives of property right structures (Fulton, 1995:1144). His arguments are based on Barzel's notion of property rights, or more specifically on Barzel's analysis of different attributes for which separate rights may be defined and whose definition is not costless.

Since positive transaction costs are associated with determining the various attributes of the same asset, it follows that the attributes can never be fully discovered and known. As a result, there will always be a portion of a property with attributes not fully known and consequently with unspecified owners. At the same time, there may be several owners attached to different attributes of the same asset (Barzel in Fulton, 1995, pp.1144-1145). Clearly, rights over a resource can be placed in multiple persons and can in that sense for a resource as a whole be collective in nature.

Against this background that spells out the difficulties in delineating clear ownership limits between different owners of the same resource, Fulton examines the organizational context of a cooperative enterprise. He argues that when there is a considerable variability or unpredictability attached to a specific input in the production process, the residual claimants of the income flow generated through the asset as a whole should be the same as the owners of the variable and unpredictable input. Therefore, it is suggested that „cooperatives are more likely to emerge and be successful in those situations in which the input provided by the members is subject to unpredictable variability“ (Fulton, 1995:1146).

However, the lack of clarity for all properties of a resource may in the case of cooperatives lead to an increase in opportunistic behavior on the part of some users and according to Cook (1995: 1156-1157) is useful in explaining the emergence and persistence of some of the most common cooperative problems:

- a) Free rider problem – lack of property rights clarity instigates opportunistic behavior in some members and non-members;
- b) Horizon problem - lack of clarity disincentivizes members from making investments because their residual claim on the income generated by the asset is shorter than its lifecycle;

- c) Portfolio problem – primarily related to the lack of transferability of rights in certain circumstances which limits the ability of members to adjust the portfolio of their cooperative to their risk preferences;
- d) Control problem – may sometimes arise in complex cooperative structures when there appears to be a rift between members and the elected board or an external manager;
- e) Influence cost problem – happens when the heterogeneity of members' interests becomes too much of a burden for cooperatives internal structures to coordinate.

Cook further argues that cooperatives react to these problems by adjusting their property right structures. They do so in a number of ways. Some decide to exit the cooperative market altogether abandoning the cooperative form in favor of the IOF form. Others may decide to ameliorate the undercapitalization concerns by diversifying ways in which capital can be collected outside of a cooperative and adjust the property right structures accordingly. A third strategy, Cook argues, is the transformation of a traditional cooperative form into a new generation cooperative, a new form which through its market orientation and a number of mechanisms, such as asset appreciation tools and membership policies, eases the constraints posed by unclear property right structures. But Cook himself clarifies that the efficiency emanating from the way in which property rights are allocated in cooperatives very much depends on the legal framework in which cooperatives function.

### Private, state, social or cooperative property?

There is an increasing need to address property rights issues in countries that replaced their socialist economic system with open market system. The concern is obvious and pertains to the ability of newly formed institutions to regulate and organizations to adjust to swift and overwhelming changes in all aspects of life. Such abrupt institutional transformations have brought to the fore the dynamic relationship between various owners of the same properties.

For a number of their internal specificities, the cooperative sectors in post-socialist countries have been especially susceptible to an uneasy tension between various classes of rights' claimants. This primarily has to do with legal treatment of cooperative members' private property during socialism as well as the subsequent treatment of collective cooperative property, acquired by a cooperative itself, following the introduction of capitalism in these countries.

As for the socialist regime in Yugoslavia, the details and consequences of many agricultural reforms that had upset the balance in the institutional environment of former Yugoslavia were discussed in Chapter IV. Suffice it to note here that they collectively had contributed to creating an unstable and insecure institutional environment for development of cooperative identity and

enterprise. Currently, the institutional environment pertaining to property rights in cooperative sector cannot be said to be enabling to cooperative growth. This is the conclusion that can be derived from Chapter V. Acknowledging the findings from these two chapters, the present chapter is concerned with only one notable effect of frequent policy changes and reforms stemming from socialist times and that is the effect of these changes on the ownership titles in agriculture.

The ability to hold recognized property rights over an asset is an integral part of a functioning market economy. Without the ability to practice the right to own, rent, sell or otherwise manage assets, the production process itself ends up being confined to the limits set by the ill-defined property rights regime. Effectively, this means that any future developments are constrained by risk-averse behavior and lack of investments, all consequences of insecurities in property rights. Furthermore, in addition to stifling growth of income that could otherwise be generated through the property in question, the absence of clear property rights in agriculture affects the functioning of a number of supporting markets, including the land market.

As suggested in the literature, the evolution of property right structures takes on the characteristics of the socio-economic environment in which they appear. In order to look into the evolution of property rights in BiH cooperative sector, it is necessary to place this process within a wider framework of relationship between state, individuals and cooperatives.

Šoljic et al. (2005) suggest that this relationship has gone through at least four distinct periods starting from the 1900s when first cooperatives were formed as an expression of farmers' initiatives, to period from the end of the WWII until 1950s when the state structures exerted the greatest levels of control over cooperative movement including taking control of cooperative property, to the introduction of Yugoslav-specific self management in agriculture from 1950s till 1970s and the final phase marking a move towards greater liberalization of markets including the agricultural market from mid 1970s until the final dissolution of Yugoslavia.

First cooperatives in the former Yugoslavia were created well before the onset of socialism. However, once the new system was introduced after the WWII cooperatives were targeted by then policy makers for their capitalistic nature. The main critique against the model was that it functioned based on preserving the private rights of members over the property brought into cooperative. Ironically, once socialism was replaced by market economy cooperatives were perceived as remnants of socialism and are often criticized for their inefficiency that stems from its 'collective' nature.

Specifically during the times of socialism in the former Yugoslavia, the notion of property rights was often reduced to mere ideological issue with little regard for its economic repercussions. At the time, and as a result of numerous constitutional changes, a category of

'social ownership' was introduced to signify literally the new owner of resources - society as a whole. Although this was perhaps the most visible expression of then ideological and political shifts towards more communality in economic affairs what it did in reality was to blur one of the most fundamental ingredients of economic progress – clear land titles and ownership rights.

As a result, after 1990s when open market economies replaced state guided markets, the category of 'social property' became first politically contested and then irrelevant or at best hard to define and translate into terms acceptable to capitalist economic system. In some countries, like Slovenia for example, law regulated that all social property that was once transferred to cooperatives through various policy instruments or had been used by them for an extended period of time became cooperative property with full ownership rights.

BiH transition towards market oriented economy was considerably slowed down by a devastating war and resolving various property rights related issues was delayed until after the atrocities were over. The political system of BiH introduced in 1995 was a tough compromise between the warring parties and it clearly placed no priority on resolving the title of 'social property' in BiH cooperative sector. Additionally, the new system of market economy recognized only the public-private dichotomy. The legislation on cooperatives was silent on this matter. The title over cooperative property that was once in the 1950s labeled social thus remained unresolved in many BiH cooperatives.

Although the General Law on Cooperatives in BiH from 2003 clearly settles this issue in favor of cooperatives allowing them to reclaim their full ownership rights over contested property, its inconsistent application across BiH and at different levels of governance has made matters even more complicated.

Absence of systematic treatment of property rights in agricultural sector prevents cooperatives in particular to reach their full development potential. Their inability to claim and use their property may be responsible for their general lagging behind other actors in BiH agriculture in adjusting to market economy.

Although there is no official estimate as to the value of property with unresolved status, it has been roughly estimated that there is around 14 million KM worth of property with unclear title in the RS, and around twice as much in the FBiH.<sup>60</sup> Many inactive cooperatives still hold property that is not being used and cannot be transferred to other users due to its unclear status.

The General Law on cooperatives is clear regarding the property with unclear status – all property with unclear property rights that is found in cooperatives, either as land or moveable property, is to be registered as cooperative property. However, in its provisions, the RS 2009 Law on agricultural cooperatives allows for unclearly titled property (which refers primarily to social property that had been used by cooperatives) to be appropriated by local municipalities.

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<sup>60</sup> Personal interview with an employee at the Cooperative Association of BiH, August 2012.

Therefore, cooperatives in RS are not only treated in a manner that contradicts the state level law but are discriminated against because no such law is applied in other parts of the country.

The next section is a case study of ten agricultural cooperatives where the issue of unresolved social property appears to be the gravest.

## Case study

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### Background

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The problem with property rights in BiH cooperative sector is both institutional and practical. Institutionally, it is rather problematic that since 2003 there is the Law that defines a clear solution to the problem of unclear property rights in cooperative sector and that its implementation has been only sporadic and effective in only one part of the country.

Practically, for many cooperatives in RS the existence of the state level Law which allows them to register as legal owners of social property found in cooperatives has had little effect. For them, defending their right to use property either for productive purposes or as collateral has proven to be costly. On a very practical level, there are recorded cases in RS where municipalities have taken over the ownership of property refusing to recognize the legality of contracts that document that cooperatives purchased the property from a third party. Many RS cooperatives invested considerable sums of money into new infrastructure and mechanization only to see it taken by municipalities. Much of the agricultural land that has been appropriated in this way in RS has seen its purpose being changed from agricultural to construction land and rented or sold to various local businessmen.

In addition to not being able to affect local politics, cooperatives have had a mixed support from legal system, and only sporadic support from cooperative associations. Already complex and costly legal procedures were further made more complicated by municipalities' issuance of separate expropriation decisions for each land parcel, or other type of property, even if the property in question is being used by the same cooperative. As a consequence, when making an appeal to local courts regarding municipalities' decisions cooperatives were required to pay a separate fee for each document. This not only increased the cost of the process itself but in many instances drove cooperatives into unwanted prioritizing among many contested pieces of property – it was too costly to legally pursue the confirmation of ownership for all. Some property was therefore simply foregone for the mere cost associated with an attempt to prove ownership. Needless to say, these costly and lengthy procedures undermined the productive capacities of many cooperatives in the RS.

Unlike in RS where the legal framework itself allows municipalities to acquire land or property with unclear titles, local authorities in FBiH have no such legal grounds on which they can claim ownership over cooperative (social) property. However, this has not stopped the

authorities in certain FBiH municipalities, especially those close to RS municipalities, to forcefully take away the property with unclear title. All the attempts to reclaim the property from the municipality have so far proven to be futile.

Against this background, this section seeks to explore and explain the channels through which matters of unresolved property rights affect the ability of cooperatives to grow, develop, and be more productive enterprises.

## Methodology

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In a sample of 210 agricultural cooperatives used for this research, 37 of them reported presence of some social property or property with unresolved status. Since the sample itself contained only those cooperatives that reported some economic activity, and were thus still considered active, the assumption is that there are many more cooperatives that face similar problems but were not included in this sample. The exact numbers are impossible to tell due to lack of official sectoral statistics. However, the knowledge that there is property with unclear status that is locked in many inactive cooperatives and thus ends up being unreported serves to further emphasize the importance of this issue.

The cooperatives that were studied in greater detail for the purposes of this chapter are those that either reported to have significant percentage of their property with unresolved status (60% or more), have considerable number of members and cooperants (small cooperatives with less than 10 members were thus eliminated), and have tried to pursue their ownership right over the problematic property. The idea behind these selection criteria was to isolate those cooperatives for which more than half of their property might be at stake and whose membership and cooperants' base is wide enough so that losing the property, or not being able to activate it for productive purposes for an extended period of time, is felt among considerable number of people. Additionally, it was important to include in the study those cooperatives that have tried to exhaust all available legal means in order to prove the ownership right so that the costs of these procedures may be estimated, but also in order to look into the existence of support services to cooperatives with this problem.

A sample of cooperatives was selected that also took into account the entity dimension primarily because of the existence of different legal treatment of social and cooperative property in two entities. One cooperative from Brčko District was also included in the study.

Inactive cooperatives were not taken into consideration on the account of the fact that the impact of property that was locked in inactive cooperatives was detrimental to agriculture just by not being used by anybody.

The research based on interviews with cooperative directors, cooperants and their associations, aimed at investigating the following:

- a) Official status of cooperative property in the selected cooperatives;
- b) Typology of the most affected cooperatives and legal origin of the problem;
- c) Channels through which untitled property affects economic activities of cooperatives;
- d) Policy proposals on how the problem with property rights may be resolved.

In essence and through thorough analysis of the above listed questions, this chapter places the matter of social property in current legal context and looks into the extent to which current property arrangements pose a constraint on cooperative performance while highlighting the development potential left unused because of the presence of the unclear property problem.

Cooperatives were contacted either in person, by phone or and email (one coop). The information on problematic issues was obtained either from the cooperative directors, their full time employees, or representatives of cooperative associations.

Directors of the contacted cooperatives were interviewed using an open ended questionnaire. The interviews were carried out from June until September 2011. The questions used to assess the magnitude of the problem are included in Appendix 2 of this thesis.

## Unclear property rights: consequences for cooperatives

Regardless of their dual nature, agricultural cooperatives are essentially business enterprises. As such, they can be understood as associations of farmers who by pooling their resources together can reduce the costs of production and in an easier way achieve what would otherwise/individually be very difficult and costly to achieve. Cooperative values strongly suggest that the resource pooling should happen on a voluntary basis. To qualify cooperatives as business entities entails that they too are market participants susceptible to feeling the consequences of market imperfections and sectoral fluctuations.

Unlike what is the general perception on how cooperatives usually deal with the market-based disturbances, they need to be endowed with internal mechanisms which can be put in use when adjustments to market demands are necessary. One of the most fundamental assets for agricultural cooperatives, besides the human resources, is the ability to be fully in control of their property. As was highlighted in previous sections, cooperatives in BiH are constrained in exercising their ownership rights over their property, especially land. Even though, as a sub-sector of BiH agricultural market, cooperatives are not the most productive organizations they are limited even further by not being able to fully use market opportunities in agriculture and develop their productive capacities even further. A number of reports on the situation of agriculture in BiH recognizes that small land parcels and a dysfunctional land market are among the most prominent barriers to growth and development of agricultural activities but often fail to recognize that the problem that lies at the heart of these two has to do with property right structures as currently practiced in BiH and its entities.

When agricultural land is not held under clear and well-defined titles, when transaction costs associated with the transfer of ownership are higher than the expected benefits of the purchase, and when economies of scale in production cannot be reached due to persistence of large numbers of non-contiguous land parcels restructuring agricultural production and improving the capacities of organizations in agriculture will remain a persistent development challenge.

One of the most cited hindrances to improving the competitiveness of domestic agricultural producers in BiH is the small size of plots BiH farmers cultivate. Incomplete land registration, and generally unsystematic process of registering the land and transferring its ownership over the course of history have contributed to current land prices being depressed, further driving down the demand for agricultural land.

In the 2011 survey of land market dynamics in BiH, it was found that of all the surveyed landholdings, around 34% in FBiH and 21% in RS, are currently uncultivated and would be available for sale or rent if the matter with property ownership and land titling were to be resolved (USAID/SIDA, 2012).

Apart from limited land supply, farmers who would perhaps consider expanding their farms and production face problems with financing land consolidation. Further harmonization of land register and cadaster as well as their modernization could facilitate transactions in the land market thus potentially contributing to farm consolidation in agricultural production.

Out of 74 cooperatives from the RS that provided data on this matter, 20 of them indicated that they currently hold some 14 million KM value of property with unclear title. Cooperatives functioning on the territory of FBiH reported to have some unsettled issues regarding the pre-war property but in most cases were not able to specify the value of the property. Nevertheless, some rough estimates suggest that there could be around 38 million KM in movable and immovable property with unclear title mostly in cooperatives that are still active. It is very difficult to properly estimate the kind and value of unsettled property owing to the fact that many of the cooperatives that hold some of that property are either inactive or in the process of liquidation, or otherwise impossible to reach. There is no formal account of property with unsettled status.

With a very high degree of confidence, we can claim today that unresolved property rights and unclear title of social property locked in cooperative assets are negatively associated with cooperative sector's performance in BiH. This poses a problem because it points out to the existence of a missing link in the transition process in BiH – the ability to have a dynamic and functional market economy of which the bundle of rights to control, use and transfer property from unproductive to more productive entities is the essential part. Additionally, pursuing legal means of settling the issue creates additional and unplanned costs.

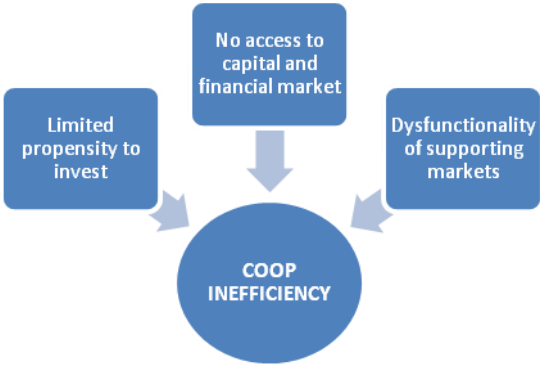


For example, two agricultural cooperatives in RS 'Bijeljina' and 'Gradiška' were both affected by the provisions of the RS 2009 law on agricultural cooperatives which allows expropriation of property by municipalities. They both appealed to the Constitutional court of RS asking for the Court to judge on the constitutionality of the 2009 law justifying its appeal on the grounds that in articles referring to property rights the RS law is in contradiction with the 2003 General Law on cooperatives.

During the Court session from 7th October 2010, the Court refused to rule on this matter stating that it has no legal competence to decide on it. Two months later, on 7th of December 2010 the appeal was filed with the Constitutional court of BiH with the request to rule on the decision of the Constitutional court of RS from 7th of October 2010. In April 2011, the Constitutional court of BiH passed a decision that it has no jurisdiction to rule on this matter. By appealing to the Constitutional court of BiH, cooperatives from the RS which were undermined in value due to expropriated property by their municipalities have exhausted all legal instruments in their search for revision of the current property rights structure.

In the meantime, while the current property rights structures are in place, cooperatives affected by this law continue to be economically limited in their market activities. There are several ways in which their functioning in the market place has been affected by the present situation. It is depicted in the Figure 5 and further explained in the sections that follow.

Figure 5 Unclear property rights and cooperative inefficiency



Source: Own elaboration

### Investment decisions

Property rights structures condition investment behavior of farmers, especially when it comes to long term and significant investments. In agricultural cooperatives in particular, investment behaviour is conditioned on two processes that are generally not found in conventional firms. First of all, the decision to invest must be agreed among all members which, given the participatory governance structure, may in many cases prove to be lengthy and costly process. Secondly, cooperatives have two general sources of funding, one being their members

and other financial institutions. Members are limited in number, and in many developing countries rather poor themselves, so the source of funding that relies on members' contribution is very limited. As for financial institutions, cooperatives have to be able to prove their financial health before they are approved investment capital. There is another source of investment capital – state. Given the status of agricultural cooperatives in BiH and their general relation to public institutions, all three sources of investment capital seem to be hard to reach.

Agricultural cooperatives studied all admit that their investment behaviour has been significantly altered with prospects of the cooperative property being expropriated. According to their experiences so far, limited subsidies that can be secured from various sectoral institutions are never enough in terms of really changing the course of their production and upgrading the quality of their products. In other words, the amount of money received from the public sector can rarely be classified as a major investment.

To make any concrete changes and improvements in the production process, cooperatives opt to devote larger or smaller amounts of what they earn through their activities to internal investments. Given their difficult position in the market in general, the investments are made with great caution and there is usually a high level of risk-averse behavior shown by most cooperative directors. This is partly related to the general conditions of legal insecurity making any investment risky. Therefore, many cooperatives refrain from making big investments simply because they are not sure that the property in which they invest will stay in their possession long enough for them to bear fruits of their investment.

Most of the large investments that were made in cooperatives that were interviewed were made thanks to the donor aid that was specifically targeted at infrastructural improvements and technological aid to the production process.

One interviewed cooperative from the RS reported that just several years prior to its property being expropriated by the municipality it has made an infrastructural investment in the value of 450.000,00 KM. In 2002 when the investment was made it appeared to be a move that would secure a better position of the cooperative in the marketplace. However, the property was taken away despite the existence of the contract proving that the property in question was purchased by cooperative in the late 1950s. Such insecurity puts off farmers but it also puts off international donors in terms of their own development decisions. Spending money on property with unclear or otherwise insecure title amounts to one-time investment for which one cannot expect any long term gains. It quickly became clear to many of the currently present international development agencies that a specific target group of investment beneficiaries need not be the final recipients of benefits once the return on investment is there.

Although there are no legal grounds on which FBiH institutions can appropriate the property of cooperatives, a cooperative from FBiH reported that their local municipality simply

expropriated its property located in the city center and rented it to a local café. And this was the shop where cooperative members used to sell their goods to city dwellers. After the property was taken away they lost their access to the market but instead decided to start selling the products by the road – which is clearly not a long term strategy. The cooperative appealed and is yet to receive a decision from the court. When prior to this happening the same cooperative attempted to register all of its property with the local municipal court, the court officials refused to carry out the registration process on the grounds of not being sure of the proper nomenclature to use for cooperative property. This is quite odd since the 2003 Law itself uses the construct ‘cooperative property’ to denote property acquired collectively by cooperative members or ‘social property’ that was used by the cooperative for an extended period of time. In this case, as it was explained by the cooperative director, there was simply too strong of a connection between local power politics and legal institutions for a small local cooperative to break.

While there is obviously a lack of coordination between different legal bodies in BiH and local governance levels in FBiH, it also appears that the lack of legal clarity, or in this case the absence of the official interpretation of the General Law on cooperatives, is used as a pretext by public bodies at different levels. It is unacceptable that a cooperative is refused registration of its property simply on the grounds of court not being aware of the proper nomenclature. Many of the interviewed cooperative directors highlighted that the presence of local power politics is sometimes stronger than valid legal framework.

Additionally, all cooperative directors interviewed singled out an issue of administrative complexities with which they are faced when trying to handling the property rights related problems. Essentially, they are unsure who to complain to when problems with property arise. Apart from laws being in need of harmonization, there is an urgent need for some sort of cooperative help center or an extension/legal service being set up with the aim of guiding cooperative managers in cases of grave violations of their rights. This would save a significant cost of time necessary for cooperative managers to locate within the complicated administrative system an institution which has jurisdiction over the property matter in question. Unfortunately, despite their membership to cooperative association they received no help, legal or financial, from these apex bodies in trying to resolve their problems.

## [Access to finances and credit market](#)

One of the things that cooperatives could assist their members with is access to finances and credit markets. Individual farmers often do not have their own property of great value that could be used as collateral when seeking bank loans. However, the value of cooperative property does allow for big loans to be taken and invested in the common interest of all cooperative members.

Quite obviously this cannot be done if ownership of property cannot be properly proved.

All of the interviewed cooperatives reported this to be one of the major obstacles to their development. Normally, they would be able to plan their activities and invest in improving the production if they could have full control over all of their property and if they were free to sell, rent or simply place property as collateral for loans. Currently unclear system of property titling and contradicting state-entity laws do not allow for such free use of property.

### Dysfunctional land market

An overwhelming majority of property with unclear titles refers to land that was during the socialist times transferred to cooperatives for use and remained in their possession until today. Apart from fertile arable land, property classified as land also refers to forests that were once owned by cooperatives. Because of lack of clarity as to the status of this property, it can effectively be considered inactive, dead capital.

With the cooperative property sitting idle, credit markets are inaccessible for many of them since they have no valuable property registered as cooperative property. Furthermore, the inability to sell land or rent it makes it very difficult for potentially more efficient landless farmers to acquire new land, and for those farmers who do not wish to use the land to make the transition to some other off-farm activity. Consequently, the land market is rather flat and almost non-existent while the problem of small and fragmented parcels of land continues to limit cooperatives from reaping the benefits from economies of scale.

All interviewed cooperatives singled out the issue of great costs associated with proving the ownership over property with unclear title. Potential investors are often discouraged when offered to invest in such property, and current users, most often cooperatives, have to spend a lot of their already limited resources in order to prove some sort of ownership. This is often done by proving the validity of purchase contracts from before the 1990s when most of the unclear property was acquired by cooperatives. However, in a fragmented legal system with different laws being valid in FBiH and RS investors often doubt in their ability to protect the ownership of the property even with the presence of the actual purchase contract. Three cooperatives reported that despite having the contract that proves the purchase of agricultural land the parcels were confiscated anyway by the municipalities, their purpose was changed and they were sold to private investors to be used for non-farming purposes.

In the case of all surveyed cooperatives, unsecure land title significantly determined the land use decisions. Land parcels with unclear titles were usually the last ones to invest in. This left a considerable mark on their long term productivity and quality. On the other hand, this also produced opportunistic behavior on part of some cooperative directors/members who sought to maximize their own personal gain from using a specific parcel of land without much regard for

cooperative principles and consequent land quality degradation. The cases of opportunistic behavior were frequent as reported by cooperatives surveyed.

## Conclusion

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Resources are scarce. The rules that societies devise regarding the use of scarce resources have an impact on both augmentation of economic power and individuals' utility decisions (Libecap, 1989; Furubotn and Pejovich, 1972). These rules, or property right structures, guide our economic behavior, our investment decisions (Demsetz, 1967). Right to a resource may be of different kind and determining characteristics of a particular resource that can be subjected to different use is usually costly. Following from this, it is essential for economic efficiency of enterprises that property rights are assigned with as much clarity as possible so as to ensure efficient allocation of resources.

This chapter looked into current property rights structure in BiH cooperative sector with aim of identifying channels through which currently unclear rights to 'social property' in cooperative sector affect the functioning of cooperatives.

The main findings suggest that prevalent lack of clarity in property rights of social property affect investment behavior of cooperatives, their ability to access finances, and limits the functionality of other supporting markets. Ten cooperatives which have more than 60% of their property with unclear title were surveyed to understand the challenges arising from this problem. Cooperatives reported that insecurity in their legal environment, strong ties of local power politics to legal institutions, lack of adherence to state level laws all contribute to cooperatives underinvesting in property with unclear title.

Additionally, not being able to use ownership rights cooperatives are further limited in the amounts of investment capital they could otherwise acquire in financial institutions. Aside from not being able to improve their productive activities owing to unclear property rights, cooperatives have to undergo costly and lengthy procedures of trying to prove ownership over property expropriated by local municipalities. Naturally, this diverts both time and capital away from their regular activities driving down their overall performance.

The support system of cooperative associations that should in theory help cooperatives navigate their way through these legal battles has been inefficient if not altogether missing. Although the solution to the quagmire of property with unresolved status and rights formally exists in the General Law on cooperatives in BiH, the failure of relevant institutions to ensure implementation of its property related clauses contributes to increasing systemic and institutional insecurity in BiH.

# Chapter VIII

## Cooperation among cooperatives: the case of Cooperative Business Network in BiH

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Finding the new *raison d'être* for cooperatives in the era of globalization does not imply that the cooperative movement by this alone is capable of taking up and successfully meeting the challenges it faces. One difficulty in particular overshadows all: how to avoid the risk that the unavoidable need for capital to finance growth may lead the cooperative to water down its identity and finally lose sight of the fact that the distinctive property of this form of enterprise is to always keep together co-substantial, mutual solidarity and economic activity.

*(Zamagni and Zamagni, 2010)*

### Introduction

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In his influential paper on basic cooperative principles John R. Dunn argues that the main philosophy behind any cooperative action is rooted in the strength of individuals joining together to provide for a specific need in a cost-effective way and within the framework of “joint effort and mutual self-interest” (1989:83). Above all, he argues that the design of cooperative organization depends upon translating this philosophy into functional cooperative principles. The success of cooperative organization, on the other hand, depends on how closely aligned cooperative practices are with cooperative principles. In Dunn’s view, three basic cooperative principles are: the user-owner principle; the user-control principle; and the user-benefit principle. These principles are mutually interrelated and “an organization that transforms the three basic principles into an operational reality can be said to be operating on a true cooperative basis” (Dunn, 1989: 85).

An important element worth considering when assessing the approximation of practices to principles is that of incentives that drive members to form, run and sustain cooperative enterprises, be they of primary or secondary nature. This is to say that there needs to exist a least common denominator of members’ interest that would incentivize them to create cooperative enterprises. Absent this crucial element, members will find it hard to perceive the benefits of the cooperative and will consequently fail to move forward with as simple task as setting it up. One implication of this insight is that cooperation, to be successful, must be driven by clear and common interest of its final beneficiaries, i.e. members. This has clear policy implications in a sense that policy makers who wish to advance cooperative sector as a whole should not force upon cooperatives more complex, secondary cooperative structures prior to

making sure that there is some common interest that will in and of itself drive the formation of such structures. Simply setting up second-tier cooperatives or other forms of federated structures with the hope that they will drive the rural development agenda forward is not a solid policy advice. Such structures need very strong and elaborate governance rules in order to yield benefits to their members and it is members themselves who, based on their vested interest participate in generating these rules.

Following this idea, and in line with contributions from networking and social capital perspectives, the objective of this Chapter is to understand what incentives are necessary to make the second-tier cooperative structure functional. Therefore, the main questions asked to that end are: do cooperative enterprises tend to be naturally more prone to mutual cooperation? What particular economic and social incentives enable this process? Additionally, what factors may distort formalizing cooperation among cooperatives or in other words, why cooperation among cooperatives fails?

To answer these questions, the Chapter assesses the importance of economic incentives for bringing cooperatives together under the umbrella of a second level cooperative, their mutual trust, and the importance of their social capital as well as self-perception of their cooperative identity vis-a-vis their potential collaborative partners. Based on the literature review and knowledge of the context, the Chapter hypothesizes that absence of clear economic incentives coupled with low levels of institutionalized and interpersonal trust tend to preclude cooperation among cooperatives.

Cooperative Association of BiH initiated a process of establishing a second level cooperative among twenty volunteering primary agricultural cooperatives. The Cooperative Business Network (CBN), as this structure was supposed to be named, was never formally established. The findings presented in this Chapter are drawn from two focus group discussions with twenty cooperative directors who took part in the project as well as representatives of the Cooperative Association of BiH; these meetings were organized between September and December 2011. All cooperative directors filled in a questionnaire which was designed to understand the nature of the cooperatives that volunteered to participate in this project and reasons for the overall failure of the CBN idea to take off. The questions and discussion structure are attached in Appendix 3.

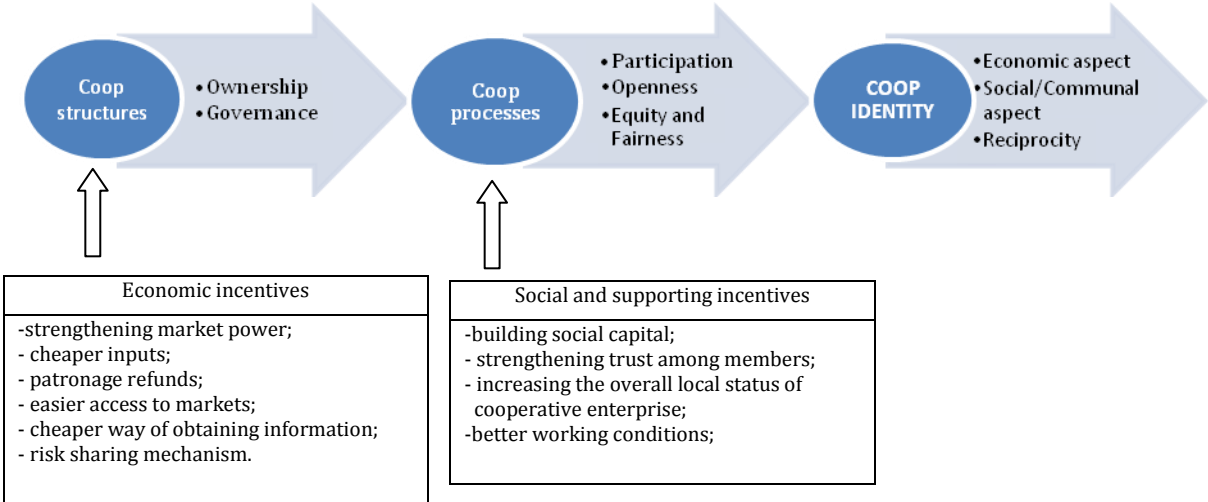
## On cooperative structures, processes and identity

Cooperative enterprises emerge as tools through which individual members meet their economic and social needs and they do so in a manner that allows them both to economize on costs and to disperse the risks associated with pursuing these needs individually. Members seek to meet their needs through specific cooperative structures as well as cooperative processes that form the essence of formal structures. However, cooperative distinctiveness or difference is not

only in structures but it is to be found precisely in how well the structures employ the internal processes to engage their members either directly or through representation in order to enhance their overall wellbeing and increase their long term stability. However, to get to the point of forming, joining and running a cooperative members need to be clear on the interests they seek through cooperative organizations as well as the incentives that push them to pursue cooperative way of doing business over using means of a conventional firm. In an attempt to explain why and when cooperatives engage in formalizing their cooperation through a second level cooperative structure, the three element framework following the Dunn’s view on cooperative principles is presented in Figure 6.

The illustration in Figure 6 essentially positions the three principles of cooperation as part of a longer process of moving from mere economic incentives that drive the initial stage of cooperative formation towards more social but less tangible aspect of cooperation which united together form the essence of cooperative identity. In other words, the incentives that drive the set-up process may differ from those that continue to drive the logic and value of cooperative processes practiced through these structures.

Figure 6 Cooperative structures, cooperative processes, and cooperative identity



Source: Own elaboration

In the above depiction, Dunn’s member-ownership principle is associated with the set up of cooperative structures, the control principle with how internal processes are designed and practiced, while the benefits are all found in the concept that denotes cooperative identity because it implies the unification of both economic and social incentives driving the previous two stages. This chapter argues that primarily economic incentives drive the initial establishment of cooperatives while social and supporting incentives underscoring the role of collective supplement the economic incentives in the later stages of life of the cooperative



organization. It also needs to be recognized that both these two categories of incentives produce different types of benefits for members. So, in order for a cooperative to even begin its life, its potential members must be driven by strong economic incentives to take the risk and organize cooperative structures.

In Figure 6 depiction, cooperative processes are seen to be characterized by participatory behaviour on part of members either in full or through well functioning representation; they should be fair and equitable in engaging members and distributing the benefits among them. All of these process characteristics rest on a basic assumption of trust among members and between members and their institutional and organizational environment. All the while economic interests of members remain important to the functionality of the cooperative. However, at this stage social benefits become complementary to economic ones and combined together the two underscore the distinctiveness of cooperative identity and organization in relation to other enterprises that provide only economic or only social benefits. However, before these processes unfold there needs to be a minimum of economic impetus that leads individual farmers to perceive the benefits of collective action. Once the basic economic incentives begin driving the process of cooperation the aspects that spill over from economic cooperation and contribute to the overall quality of work environment and relations among members may even serve to reinforce the productivity levels among members.

The organic nature of cooperatives, the fact that they emerge out of specific circumstances as well as their inclination towards subduing individual profit making to collective well-being of all members makes them particularly attractive economic organizations for highly risky industries such as agriculture. They are invaluable mechanism for enhancing the performance of small scale farmers in fragmented agricultural markets by providing them a crucial market entry point while ensuring that they are protected from competitive pressures resulting from their overall socio-economic embeddedness into the environment. The most obvious way to strengthen the market position of primary cooperatives beyond uniting individuals is to engage in creating second level cooperatives or federated structures which primarily serve to enhance their productive capacities. However, despite obvious benefits that second level cooperative structures provide they are rather rare especially in less developed post-socialist countries and not for a lack of trying.

The following section explores the content of both economic and social incentives that are seen to be indispensable to both setting up and running second level cooperative structures.

## Cooperation among cooperatives: economic and social incentives

This section outlines the content and purpose of two types of incentives that underpin different aspects of cooperative principles and practice, namely economic and social incentives. While the role of incentives in cooperatives has been studied rather often (Sexton, 1986, 1990; Fulton and Giannakas, 2011), insufficient attention has been paid to understanding incentives that drive the formation of second-tier structures among cooperatives. Hansmann (1988) who explained the formation of second-level cooperatives using a similar cost of ownership argument is an exception in this regard. However, while Hansmann argues that ownership costs of establishing second-level organizations or similar federated structures relative to costs associated with engaging the alternative contractual relations would determine whether federated structures have a visible advantage or not, even he assumes the existence of similarity in interests among agents who come together to form a second-level structure. Homogeneity of interests is an ambitious assumption to make in the context where there is very little specialization in cooperatives and it begs the question whether that argument would stand on its own once this assumption is relaxed.

When it comes to setting up second level structures there is a contextual argument to be considered. Simmons and Birchall (2008) show that despite economic advantages contained in creating such structures their longevity and success will in large part depend on the context in which cooperatives evolve in general. In their own example, cooperatives in many socialist countries were forced upon farmers and the essence of the cooperative idea never really took root among farmers or was generally distorted due to many state interventions in the sector. As a consequence, it is difficult to see ‘home-grown’ ideas of expansion of existing cooperatives through networks and second level structures if the cooperative idea itself was “emptied of meaning” (Simmons and Birchall, 2008: 2132).

For Simmons and Birchall the very nature of cooperatives epitomized in the principle of joining the resources (physical, financial and human) in the achievement of greater market strength and negotiating power vis-a-vis other market actors both in up- and downstream industries calls for instigating higher networking avenues among them. Forming apex organizations and various kinds of federated structures is just one of the ways in which cooperatives build up their negotiating potential in their relations with business partners and political elites. These authors argue that when developed properly cooperative network structures can win for their cooperative members much needed political elites’ support without inviting the political meddling in cooperative functioning.

## Economic incentives and cooperative structures

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There is a considerable agreement in the literature around the importance and content of economic incentives when explaining the emergence of cooperative enterprises. Most often cited economic incentives revolve around cooperative propensity to drive down the costs associated with purchasing input materials, use of machines, access to markets and consumers where cooperatives are described as an effective way of obtaining information. Staatz (1987), for example, in addition to arguing that cooperatives are a way of reducing production and transaction costs, views agricultural cooperatives as indispensable risk-reducing mechanism that works well in agriculture due to high asset specificity present in this sector.

Viewed through the organizational economics lenses, setting up cooperatives is justified precisely because they provide a logical structure through which small family farms can scale up the production and achieve a more effective control of transaction and monitoring costs (Tortia et al., 2013). In a gist, cooperatives serve to help individual farmers achieve what otherwise would be too costly for them to achieve individually, allowing them to pool their resources in order to reach economies of scale and aid them in strengthening their collective market power, including their power to negotiate favourable deals with other up and downstream market actors. Cooperatives may prove to be particularly useful organizational form for enhancing economic development of transition countries in which basic market economy infrastructure is still underdeveloped and some socially useful services are either undersupplied or altogether missing (Valentinov 2005; 2007).

These are all familiar arguments that explain the logic behind creation of primary cooperatives. However, it is worthwhile exploring whether the same economic incentives work well in explaining the set up of secondary level cooperative structures. Several aspects ought to be considered in this regard. First, by forming second-tier structure the principal-agency relationship present in primary cooperatives becomes more complex and if not handled properly through clear and straightforward governance structures may lead to disloyal behaviour on the part of primary cooperatives. Secondly, it is important to consider the issue of primary cooperatives' independence in relation to the second-level cooperative. One is safe to assume that primary cooperatives would want to reach a certain level of development before thinking of expanding through federated structures. Development at a primary cooperative level presupposes a certain amount of independent decision-making with regards to handling internal operations. Forming a second level cooperative at a moment where primary cooperatives are not fully aware of which aspect of their independence they would be willing to transfer to the higher up structure would most certainly endanger the functionality of the second level cooperative. Lastly, if primary cooperatives feel that they alone are able to capture the benefits

that are said to flow from engagement in second level cooperatives it will altogether disincentivize their participation.

In sum, economic incentives that trigger and justify setting up of second level cooperatives revolve around several issues: primary cooperatives have to be sufficiently developed on their own, they have to be willing to expand through second level structures rather than on their own, the level of specialization among the participating agents needs to be relatively similar which is to say that there also needs to be some homogeneity of interest among them, and the process must emerge from within the group rather than being imposed on primary cooperatives from an outside agent.

### Social incentives for cooperation among cooperatives

What do second level cooperatives offer beyond economic advantages contained in reducing certain kinds of costs for primary cooperatives and providing access to wider markets? Cooperatives are found to be important in building and strengthening social ties among their members (Sabatini, Modena and Tortia, 2012), it could be argued that having strong social capital at the basis of the cooperative enterprise paves the way for its better overall performance in the long run. Therefore, understanding and building upon the social incentive structure that relies on mutual trust, reciprocity, and strengthening of social capital can in the long run contribute to even better economic performance of participating agents. Since cooperatives are member-oriented enterprises, their internal working environment is characterized by members' engagement in decision-making processes. In such surroundings for cooperative structures to thrive, its members are required to know the ins and outs of the production processes which at the very least demand a lot of time and devotion. In that sense, trust and social capital form one of the backbones of the entire idea of cooperation. Yet, these aspects are seldom found in definitions of cooperatives of any kind. They are merely implied in a form of expectation that reciprocal relations could result from an enterprise that is jointly owned and democratically controlled by the same group of people, an implication stemming from the ICA 1995 Statement on Cooperative Identity. Two out of seven principles refer specifically to benefits that can be derived from cooperation among cooperatives and cooperatives' concern for their community. It should be born in mind, however, that social aim and contribution implied in these principles requires further specification in relation to different types of cooperatives. Surely, in that sense social aim of agricultural cooperatives will be different from the social aim of social cooperatives, for example. However, both by virtue of employing cooperative principles create a local investment and value that is seldom, if ever, provided by an enterprise of different ownership structure.

To summarize, an important role of second level cooperatives and other forms of federated structures is that of contributing to the development and strengthening of the cooperative sector as a whole but only when there is something to strengthen which is where the aspect of economic development of participating cooperatives comes in. Apart from internal mutuality of members towards one another, cooperatives are said to be characterized by a set of other principles namely external mutuality, intergenerational solidarity and intercooperative solidarity (Thomas, 2004). In this way, the specificities of the cooperative form are not only contained within the boundaries of the organization itself but are to be found in relationships the organization fosters with other actors, specifically other cooperatives. This outward orientation positions them as hubs of economic and social activities in their respective communities. In Italy, for example, cooperatives are obliged by the law to allocate 3% of their net annual profit to a fund aimed at helping the general development of cooperatives, the so called 'system mutuality'.

### *Trust and social capital as productive resources*

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Trusting is risky. Even more so in institutionally underdeveloped settings with a track record of social distrust among various groups and undersupply of certain socially useful goods. Agents supplement the lack of trust by exercising cautiousness by means of contracts which are put in place to reduce transaction costs and to minimize the instances of opportunistic behaviour. However, it is never possible to predict all the contingencies in which the lack of trust may become prohibitively costly to an agent. Moreover, even when contracts are designed as sufficiently clear and covering a wide range of possible contingencies, parties to the contract still need to trust that the mechanism tasked with contract enforcement can be relied upon.

Ring and Van de Ven (1994: 93) classify the views on trust in management and sociology into two categories: "a) a business risk view based on confidence in the predictability of one's expectations (Luhman, 1979; Zucker, 1986); and b) a view based on confidence in another's goodwill (Dore, 1983; Ring and Van de Ven, 1992)." In their article on development of inter-cooperative organizations, Ring and Van de Ven (1994) take the second view and regard trust as necessary component of inter-cooperative networking but at the same time warn that trust without safeguards built in the common structures may turn out to be detrimental to the success of the cooperative network.

In any case, engaging in any kind of economic activity or transaction requires a certain degree of the leap of faith, and inevitably entails a number of uncertainties that are not readily accounted for. However, certain economic organizations owing to their structure and general philosophy are more inclined to foster trustworthy relationships among individuals than other organizational types. In that sense, cooperatives and other grassroots organizations can be

particularly useful in providing avenues where trust can be build within a mutuality-centred structure dependent on collaboration and solidarity for its functioning. The social orientation of cooperatives, their inclusive governance and participation model are what makes fostering of trust possible within their structures and may even be termed a specific cooperative advantage (Stiglitz, 2009; Birchall, 2010).

One of the frequent arguments in favour of setting up networks of cooperatives relies on their proven ability to strengthen social ties among members and organizations (Simmons and Birchall, 2008). Social capital has become a buzz word in the field of socio-economic development and sustainability and appears to be a quintessential concept for understanding network formation. From the times when Bourdieu (1980) first coined the term to the widespread usage of the concept in the work of Granovetter (1973; 1985), Coleman (1988), and Putnam (1995) among many others, social capital was highlighted as being instrumental to the long term development of organizations, firms, and even countries, transforming it from “an individual asset to a feature of communities or even nations” (Portes, 2000:1). More specifically, social capital has come to be understood as a factor underpinning the ‘soft’ side of development, the one that is at the same time difficult to define and quantify but is nonetheless present and regarded as essential to success of the initiatives of local socio-economic development (Evans and Syrett, 2007).

There are empirical studies that evidence cooperatives’ ability to foster trust and consequently contribute to the accumulation of social capital, balancing out the relationship between the social capital itself and its organizational manifestations. Such a relationship between organizational type, i.e. more vs less/non- hierarchical in nature, and social capital and trust has economic consequences in a sense that more trust and stronger social capital contribute to lowering transaction costs and lessening overall systemic uncertainty (Sabatini, Modena and Tortia, 2012).

Against this background, Granovetter’s embeddedness concept becomes particularly useful in terms of theoretically solidifying the view that economic actions are indeed nested in a network of social relations and are consequently subject to influences that come from either weak or strong social ties (1973). In this regard, Gittel and Vidal (1998) differentiate between the two kinds of social capital, namely the bonding, or intra-community social capital which is stronger and based on cooperation and trust among community/group members, and the bridging kind, inter-community capital predicated on weaker but working relations with actors outside the immediate group. Both appear to be essential for improving economic performance, but some studies point to the fact that strong intra-group trust may, as a side effect, contribute to decreasing levels of inter-group trust.

In other words, social capital, despite its acclaimed status, has a downside as well and it manifests itself through a free rider problem, the elite capture of resources or manifested isolationist tendencies of groups with strong bonding social capital (Portes and Landolt, 1996; Bowles and Gintis, 2001; Adhikari and Goldey, 2010; Iglič, 2010). Van Deth and Zmerli (2010) cautiously condition the outcome of social capital on political and social circumstances, recognizing thus a crucial role of exogenous factors in shaping the consequences of social capital.

There are at least two important insights from the social capital perspective that are relevant to the present chapter. Firstly, the significance attached to inter-agents' social relations in determining their economic well-being and especially the evolution of their future collaboration serve to underscore time and again that no social interaction among economic agents is too insignificant to dismiss when evaluating the development potential of their mutual collaborative efforts. Secondly, for social capital to be formed, sustained and diffused, there needs to be a basic minimum of institutional stability present in a society so that agents can understand that structures through which they accumulate social capital over time serve not to replace the formal institutional structures but rather to increase the productiveness of other types of capital that are allocated in one way or another through other relevant social structures.

This second aspect has special policy relevance for societies that have, due to their political and economic instability, lost faith in their formal institutional structures and seek to replace them by a network of informal relations that bring them immediate individual benefit at the cost of building a structure that will in the long run benefit society as a whole. In this sense, Valentinov's (2003) classification of social capital in accordance with general structural level of inter-agents relations into individual, organizational and community-level social capital is very useful, firstly because it lays out the complexity of the concept itself and secondly, because it reminds of the variability of social capital characteristics at these various structural levels.

Furthermore, Valentinov highlights an important feature of social capital at an organizational level that of 'exclusion', where he argues that at this level social capital results in creating certain network externalities reserved for those who are part of the network and denied to everyone else. To substantiate the point, Coleman's view is informative: "Social capital is defined by its function. It is not a single entity, but a variety of different entities having two characteristics in common: They all consist of some aspect of social structure, and they facilitate certain actions of individuals who are within the structure." (1998:189).

Both trust and social capital are characterized by self-perpetuation: they frequent usage improves rather than depletes their quality. When cooperatives attempt to create networks they essentially have to transfer the trust existing among original, primary cooperatives' members to a newly created structure. Even if it appears that cooperation comes naturally to cooperatives, this transfer of trust from inner circle to newly created networks often goes awry.

## Case study: Description and methodology

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The need to form some kind of specialized network structure that would aid the development of cooperatives came directly from 30 cooperatives' directors and was articulated to the Cooperative Association of BiH, which using the funds from an external donor and with a clearly defined timeframe for project implementation, officially launched the creation of the Cooperative Business Network (CBN) at the beginning of 2010.

The idea was not new. It first emerged in 2007 under the name Cooperative Business Marketing Centre but it was later transformed into the CBN which was reduced in focus and generally less ambitious in its aims than the original idea. Additionally, the interest among initially interested cooperatives gradually waned and dropped from initial 30 to just 10 to 15 of them actively participating in project activities, and the rest just occasionally followed the news on CBN. As it was described in the project documentation, the original idea was to assist cooperatives in developing self-sustainable network that was to serve as a tool in improving their networking efforts as well as their relations with the Cooperative Associations and potential business partners. On the tasks of the CBN the project documentation states:

“The CBN should assist cooperatives in offering simple marketing services. Information on needs and offers, joint purchase of required products, organizing trade among members should be among regular CBN activities. CBN should be involved in planning and negotiating with food industry and supermarket chains defining long term contracts with specified demand of volumes, qualities and delivery terms. All links in the chain, from farmer to vendor should have knowledge about each other, cooperate and communicate among themselves which will optimize efficiency and minimize costs. Maintenance of this chain is responsibility of the CBN.”

In essence, the structure of the CBN was to be that of a second-level cooperative with each member contributing a specified amount of financial capital and the CBN was to have a professional manager.

The information presented in this Chapter were collected through two focus groups meetings with cooperative directors of cooperatives that remained more or less active in project activities. The initial contact with cooperative directors was made through the Association of Cooperatives' employee. It is important to note that while the number of cooperatives initially interested in this project was thirty, this number decreased to twenty which was the number of cooperatives that were contacted for this research. This research did not look into reasons why these ten cooperatives decided to be only marginally involved in groups' activities.



Essentially, the CBN was supposed to help cooperative members build social capital through a host of common and mutually beneficial activities. However, the CBN never took off. The following section explores the main reasons for this.

## Why the Cooperative Business Network failed?

As it was argued at the beginning of the Chapter, the idea to self-organize either on primary or secondary level must be rooted in evident and clearly expressed interests among final beneficiaries of benefits that accrue through working within the cooperative framework. That is perhaps one of the basic preconditions for successful cooperation in general – the need must be organic and internally generated. This is something that was only partially and vaguely present in the CBN idea. Although the request to set up such a second-level cooperative initially came from thirty primary cooperatives there was little clarity of both interests that would be pursued through such structure and vision for the future of such second-tier organization.

To begin with, the total number of cooperatives that expressed the interest to participate in the establishment of the CBN was rather small despite the evidenced need to improve the functioning of agricultural cooperatives. Furthermore, there was very little similarity among the interested cooperatives both in terms of their main activity and their membership size. This made arriving at common interest that much harder.

Generally, the findings evidenced a deficiency in understanding of basic cooperative principles and how these would function at the cooperative network level. Furthermore, the cooperative heads never discussed what the CBN can do for them all as a group but were rather focused on what the network can do for the advancement of their own cooperative. In that respect, they lacked the very basic sense of group solidarity.

When asked about their motivations for wanting to form and join the CBN, four issues arose, namely: to help them *lobby with the government institutions* in order to secure more state funds for cooperatives; to help them *develop processing and warehouse capacities*; to help them *reduce the administrative costs* they incur when trying to place their members' products on the market; and to aid them *to find information* on potential investor and business partners.

In line with Dunn's argument on basic cooperative principles and cooperative structures that in reality correspond to them, the following three sections will give a detailed explanation regarding the understanding of cooperative structures, processes and identity among the cooperatives that took part in the CBN project.

### *Cooperative structures*

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As specified earlier, to even contemplate forming second-level cooperative structures there needs to be clear, common and rather homogeneous economic interest among potential members. The nature of participating cooperatives reveals that even if the CBN was formed it would not be a successful endeavour.

First of all, most BiH cooperatives are general in nature, that is to say, they have no clear specialization but rather they service a diverse pool of members and non-members who are usually inhabitants of a limited rural area and engage in any number of agricultural activities. With the exception of two cooperatives which were production cooperatives, others were mainly engaged in getting farmers' input supplies and placing farmers' individual products on the market. None of them provided any training for their members, and only one engaged in common marketing activities for its members and for this it was heavily helped by the German Association of Cooperatives' development programme. They also came from different sub-sectors with majority of them working with fruits and vegetable producers while one with some marketing services was in the dairy sub-sector. All this goes to suggest that it was rather difficult to imagine such a diverse group of cooperatives to derive common economic interests that would spur effective second-level cooperative collaboration. There was simply nothing to work from which would engage them all as a group.

The project manager on behalf of the Cooperative Association of BiH also confirmed that cooperative directors showed a lot of distrust towards one another throughout the process of initiating the CBN among them. Apparently, as the process of setting up the CBN dragged on for two years, they felt it was generally too risky to commit any resources to the idea especially because setting it up would not guarantee a definitive business success in institutionally and legally unstable environment. The risk in this sense can be associated with two situations: either the benefit that could possibly be derived from the CBN is highly unlikely or the benefit is not clear at all. Given that some of these cooperatives were more economically stable than others, it is more likely that the latter situation applies rather than the former. The motivations for joining the CBN formation effort also support this claim. While some expected more government money to handle their undercapitalization concerns, sought help with developing basic production processes, others requested a common warehouse to store their products and inquired about ways of attracting new business partners. Their needs were diversified to the point that any joint action would only had sense if participating cooperatives were broken down in different groups based on their economic development and strength.

Furthermore, they all stated that they would not be ready to provide any resources for the functioning of the CBN (financial resources included) and that it should be entirely funded by some state agency once the donor grant is finished. This is a clear indicator that there is still a

strong expectation among cooperatives in post-socialist setting that government should stand behind something that could be entirely cooperative effort. But even beyond that, such a view testifies the lack of homogenous interest in the success of the CBN.

It was repeatedly highlighted that cooperatives face considerable costs when obtaining market related information such as potential partners in up- and downstream industries and export opportunities and they hoped the CBN would contribute to reducing these costs. However, the risk associated with making the CBN functional was apparently higher.

It was precisely lack of clear and sufficiently strong economic incentives that precluded this group of cooperatives to even engage in setting up the CBN structures.

### *Cooperative processes*

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Devising proper governance mechanisms and management structure was yet another point of contention among the participating cooperatives. Although it was generally agreed that the CBN should be a business oriented body with a professional manager there was a lot of disagreement as to whether the only owners of the CBN should be participating cooperatives or other entities and organizations that are not of cooperative nature should be let into the structure. When it came to the choice of the CBN manager, it was repeatedly brought up that if the CBN director was to be chosen from among the group he will use the network to favour his own cooperative even if he denounces his membership from his cooperative – thus they were concerned about the control and monitoring mechanism that should be in place. It appeared that the reason why some of the cooperative directors were in favour of an external, professional manager was not their conviction that an external manager would mean more efficiency but it was their lack of trust in their fellow colleagues' ability to remain objective in his/her work.

None of them perceived common marketing activities as something that could potentially help their market placement although marketing was clearly not provided through their present primary cooperative structures and was expressed in the project documentation as one of the main objectives of the CBN. Clearly, there were conflicting objectives between the project implementation team headed by the Cooperative Association of BiH and participating cooperatives' directors. Although the project initially envisaged the establishment of a credit line for members of the CBN, cooperatives were very distrustful of the idea dismissing it outright as something that would certainly never work because *'it has never been tried before'*.

Without any exception, cooperative directors confirmed that it was the lack of trust that prevented them from formalizing the CBN. There was a lot of uncertainty expressed with regards to the idea and justified on the grounds that it would be a complete novelty in the BiH cooperative sector. Additionally, participating cooperatives were uncertain about its internal structure and its financial feasibility once the donor funds phase out.

Another interesting insight emerged during the interviews. None of the directors held detailed discussions on issues pertaining to the CBN with their wider membership base and it was always the same group of people who acted as cooperative representatives at the meetings organized by the Cooperative Association.

### *Cooperative identity*

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Despite the fact that BiH agricultural market is relatively small and the number of active agricultural cooperatives is most probably nowhere above 250, cooperatives seem to imagine their development trajectories as rather isolated from their cooperative counterparts. They fail to see the areas of mutual cooperation but rather view each other as competitors for government subsidies, grants and market share. This can partly be attributed to the lack of devotion to true cooperative principles and goes to show that majority of cooperatives that are active in BiH market put emphasis on their own 'collective or cooperative profit seeking' behaviour at the expense of social and community-caring component, however paradoxical this may sound.

Unlike in some other European countries where there is a legal requirement for cooperatives to contribute a part of their earnings to development of other cooperatives, there is no such initiative in BiH agricultural sector. Cooperative directors feared that whoever manages to gain the leadership position in the CBN will use it to build his individual social capital base. On the contrary, what prevailed are the self-oriented and selfish behavioural traits on part of cooperative directors who sought individual benefit rather than collective or community well-being. None of the interviewed directors mentioned potential benefits that would accrue to their communities had they managed to strengthen their market presence and power through benefits of network cooperation. Cooperative principles of care for community and inter-cooperative collaboration did not rank high on the list of priorities for this group of cooperatives.

There are also several aspects that pertain to the institutional context more than to the group characteristics itself that were brought up to explain why forming a second level cooperative is proving to be such an insurmountable task for BiH cooperatives. Among the most prominent problems was that related to unresolved property and how limiting it was to their ability to expand production and reach bigger markets. Secondly and related to the previous point, they objected the strictness of the financial sector as a whole when it comes to approving the loans to cooperatives. In their view, financial institutions still see them as inefficient enterprises and are not eager to extend their credits to them. In the absence of adequate state funds aimed at sectoral development, cooperatives find themselves unable to finance their own growth and development.

Table 17 Obstacles to establishing the Cooperative Business Network in BiH

Obstacles Identified	Detailed responses
<b>Lack of proper institutions</b>	Absence of state level ministry and vision for agricultural development; insecure and unreliable legal system; complex legislature and administrative procedures associated with establishing a new legal entity; lack of public sector support to cooperative consortia; ill-defined property rights system; no place for cooperatives in rural development strategies; improper implementation of current laws;
<b>Lack of initiative and organizational flexibility of existing cooperatives</b>	Lack of funding and human resources that could be devoted to the project; lack of good quality products worthwhile of common marketing through second level coop; lack of trust among cooperatives themselves; lack of interest to engage in innovative ways of raising capital for cooperatives; no secure market for placement of cooperatives' members products; unwillingness to take any risks.
<b>Market related obstacles</b>	Small size of the market in BiH; lack of available information on benefits from primary and secondary cooperatives; cooperatives perceived as unreliable partners in the market.

Considering the embeddedness of economic activities in a network of social relations, and weakened inter-communal trust among various groups in BiH due to recent atrocities, social capital creation through innovative organizational types may be perceived as risky in BiH, or at the very least may be frowned upon if attempted with 'the wrong' or not-socially approved group of people. In such environment, farmers would rather stay isolated in their small communities than explore networking possibilities with groups whom they are distrustful of.

Cooperative directors interviewed for this research were asked about the extent to which they believed the ethnicity itself impacts the mutual relations among cooperatives since no instances of functional and lasting inter-ethnic cooperation are recorded to date. They insisted that the lack of trust among them is not related to the fact that they belong to different ethnic groups. Instead, they are distrustful of the entire institutional surroundings and a sense of 'cooperative spirit' in their potential partners. In their view, lack of trust is primarily related to economic behaviour of their partners which they feared would be self-oriented rather than exhibiting features one could consider a part of cooperative identity.

## Conclusion

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Agricultural cooperatives are formed for a variety of reasons some of which are purely economic while others are more socially oriented. The balance between the two and clarity in both is what sets successful cooperative enterprises from those that are not, be they primary or secondary cooperatives. In terms of economic incentives, cooperatives are formed to serve as a countervailing power so as to strengthen the position of cooperatives vis-a-vis other enterprises in the market, they help individual members to scale up their production and share risks associated with innovative and new approaches, they provide their members with better access to markets and resources. In terms of their social aim, cooperatives do provide their members with ample opportunities to build trust and reciprocity based relationships equipping them with less tangible but equally important productive factor of social capital. However, the initial motivation associated with setting up cooperative enterprises of both primary and secondary nature has a lot to do with how successfully members identify their common economic interest in pursuing the cooperative way of doing business. The accomplishment of social aim in agricultural cooperatives entirely depends upon the ability of members to gather around clear and homogeneous interest.

The case study on Cooperative Business Network as a joint effort of several agricultural cooperatives in BiH to form a second-tier cooperative structure precisely shows how the absence of clear economic incentives can hinder efforts to create more complex structures. As it was pointed out in this Chapter, the participating cooperatives shared very few characteristics in common and had difficulties even understanding how their differences in interest may endanger the idea of the CBN. This is why during the discussion among them the fact that one cooperative director voiced a need/interest different from their own was understood not as a real divergence in needs but as his willingness to force the need of his own cooperative as priority for others. Such a dynamic among them further reinforced the original lack of trust and fear from opportunistic behaviour that may occur if someone from within the group were to manage the CBN.

On top of everything, there is an alarmingly high level of distrust between cooperatives and institutional environment which prevents them from going into mutually advantageous arrangements even when there are favourable economic incentives. Instead, cooperatives perceive of other cooperatives as competitive partners. When cooperative idea is reduced to just cooperative structures, absence of trust further solidifies already weak market position of cooperatives. As a result, a vicious cycle is created in which weak cooperative identity further undermines formal cooperative structures which in turn again reinforce weakening of cooperative identity.

# Chapter IX

## Envisaging the pattern of transformation

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There is but one mode by which man can possess in perpetuity all the happiness which his nature is capable of enjoying, — that is by the union and co-operation of *all* for the benefit of *each*. Union and co-operation in war obviously increase the power of the individual a thousand fold. Is there the shadow of a reason why they should not produce equal effects in peace; why the principle of co-operation should not give to men the same superior powers, and advantages, (and much greater) in the creation, preservation, distribution and enjoyment of wealth? (Robert Owen, 1826)

### Why are cooperatives still relevant?

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This Chapter attempts to synthesize the analysis from previous chapters by highlighting the most important research findings. It will do so by summarizing the research problems, hypotheses explored throughout the thesis, and will relate the main findings to a set of policy recommendations. Policy recommendations proposed in this chapter are aimed at bringing the currently existing cooperative model in BiH closer to the cooperative ideal of a business and social model which favours people over capital, long term job security and financial stability over short term pecuniary gains, and rests on the notion that the benefit of economic activities should and can be equitably distributed among a united group of productive individuals.

While the reality documents growing importance of agricultural cooperatives in more and less developed countries alike, theoretical debates regarding efficiency and viability of cooperative enterprises are still present in the literature and continue to stir controversy over the role of cooperative enterprises in development.

Stefano Zamagni (2005; 2008) succinctly outlines the basic ideas of confronting approaches to studying cooperative enterprises. On the one hand, there are authors who suggest that cooperatives emerge as a response to market failures but their effect on market dynamics remains marginal owing to their inherent limitations of non-hierarchical structure and non-profit nature (Alchian and Demsetz, 1972; Williamson, 1973, 1985). According to this view, cooperatives are market occurrences that require the dominant and efficient for-profit enterprise to fail in providing a good or service in order for them to take root. They question the ability of team of workers, and in more general terms of producer cooperatives to perform with levels of economic efficiency comparable to those of profit-oriented firms. In their view, a lack of

strong incentives vested in the controller of economic activities in a cooperative resulting directly from its non-hierarchical structure, leads to situations in which all patrons/controllers tend to underperform driving down overall cooperative efficiency levels (Alchian and Demsetz, 1972). Therefore, in this view cooperatives are exceptions rather than rules.

In a complete contrast to this view is a line of thinking that positions the cooperative model far ahead of the conventional firm, characterizing cooperative enterprise as a model all conventional firms should strive to reach conditioned on their ability to perceive 'labour as the opportunity for self-fulfilment and not just as a productive factor' (Zamagni, 2008:2). This view presumes that there is more to human motivation and satisfaction than simply seeking to fulfil pecuniary desires in the working environment and that cooperatives are the precise tool that can aid in generating self-fulfilment through work while at the same time creating both economic and social spill over effects in the community.

Additionally, in spite of heterogeneity of interests and resulting complexity of the governance model, agricultural cooperatives in particular perform an important function of bringing many independent farmers together under the structure that not only serves to compel mutual monitoring for mutual interest but also provides a powerful risk-sharing and bargaining mechanism. In fact, agricultural cooperatives in particular help individual farmers resist market pressures from their up- and downstream partners giving them an opportunity to cut on transaction costs by jointly performing activities related to processing and/or marketing of their produce (Valentinov, 2005; 2007; Tortia et al., 2013).

In spite of all criticisms levelled up against the cooperative business model and in particular against its financial viability in an increasingly competitive market dominated by the IOFs, cooperatives remain important job providers to many rural dwellers as they are especially suited to create and sustain the market power of individually powerless farmers and in words of Zamagni and Zamagni (2010:vvi) "to ward off social exclusion".

The growing numbers of cooperatives worldwide testify to their appeal. In the course of the last century cooperatives recorded impressive growth both in terms of numbers and in terms of their market power. In the EU alone, where the agricultural sector accounts for about 14.7% of the total manufacturing output, cooperatives are responsible for about 38.5% of it. Around 40.000 EU's cooperative enterprises along with their 600.000 employees and around 9 million members manage to collect, add value to and place on the market around 60% of the total agricultural produce in the EU (Tortia et al., 2013). In France for example, approximately 38% of population belongs to one or more cooperatives. Germany's impressive numbers stand at 20 million cooperative members throughout the country, or 1 person out of 4.<sup>61</sup>

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<sup>61</sup> <http://www.wedge.coop/newsletter/april-may-2012/cooperative-movement-around-the-world>.



In the context of less developed and transitional countries, it is difficult to come across reliable statistics that would document the importance of the cooperative sector in the overall agricultural market. In the case of such countries, if existing, these statistics are to be cited with caution. While they may reflect the presence of cooperatives, the spread of their membership base, and their market share, they will be silent on the precise business philosophy behind the organizational borders. And in the countries in which the evolution of the cooperative movement had been interrupted by frequent and sweeping changes in political economy, the cooperative business philosophy is one thing that cannot be taken for granted. In that sense, capturing the effect of cooperative presence in developing communities requires going beyond numbers commonly found in statistical reports. That is necessary so that a working definition of cooperative identity is revealed and compared to what is internationally recognized as a genuine cooperative enterprise. Understanding the concept of cooperation as practiced in day-to-day activities of these enterprises is fundamental in comprehending the scope of cooperative development potential in these countries.

In BiH agricultural sector cooperative enterprises are still stigmatized as inefficient. Their development potential is consistently undermined on the account of how the model was instrumentalized for ideological purposes during socialism. At the same time, no serious initiative for reform emerged from within the cooperative sector itself. This research confirmed that BiH cooperatives lack a clear sense of cooperative identity, and that they practice cooperation in a formal rather than substantive manner. They find it difficult to function in a market economy and their overall contribution to rural development is marginal. Why has an attempt at adjusting to newly introduced institutions led to weakening of cooperative identity so much so that in some cases no trace of cooperative values is to be found in cooperative structures?

This thesis provides a number of explanations some of which stem from a particular institutional context in BiH while others reflect purely organizational characteristics of cooperatives in BiH. As regards the analysis of organizational features of predominant cooperative model in BiH, a sample of 210 agricultural cooperatives representing a narrow geographical space of BiH was analysed. In that sense, the findings presented here are limited to what are arguably only BiH challenges but can, with some caution, be extrapolated into a number of general recommendations for cooperative sectors in other institutionally challenged societies.

This thesis looked into cooperative enterprises as a market coordination mechanism on par with other legitimate coordination mechanisms but in interpreting its current features I looked into both the influences stemming from the institutional environment of socialism and those emanating from the current institutional framework which is a complex mixture of post-conflict

resolution tools in its own right. More specifically, the thesis aimed at investigating the extent to which the informal and formal institutional forces affect the functioning of BiH cooperative sector, it looked into the prevailing kind of a cooperative enterprise in BiH with a specific focus on the determinants of cooperative efficiency in the context studied. The research hypothesized that the meaning of cooperation is deeply embedded in a nexus of political and economic relations brought about by informal and formal institutional context which coupled with prevailing governance style in cooperatives determine both their efficiency and development potential.

Following the framework of analysis presented in Chapter I, here are the main findings of the research:

In Chapter IV, by examining the evolution of cooperative movement on the territory of former Yugoslavia I showed that frequent and violent changes in cooperative institutional environment contributed to the distorted view of cooperative function and purpose within the cooperative movement itself. This in turn affected how cooperatives defined their own identity and how they perceived the practice of participatory cooperative model which spilled over into the new institutional context of open market economy introduced after the break up of Yugoslavia.

In Chapter V, I analysed the current legal framework in which cooperatives function in BiH and concluded that it lacks both clarity and functionality and is above all aimed at regulating the cooperative sector only formally without truly engaging the issues that stifle cooperative growth. By looking into available policy instruments, I concluded that neither public institutions nor cooperative associations provide satisfactory support system for cooperative development. Therefore, the existence of cooperatives and their current contribution to agricultural growth and rural development is accidental and not part of a larger strategy of rural development in BiH despite their potential in that regard.

In Chapter VI, I looked into institutional and organizational factors that affect cooperative efficiency. Based on the prior knowledge of the sector and currently prevalent cooperative business philosophy, I used a measure of efficiency which in essence reflects only monetary gains of members and cooperants. Several interesting findings emerged from the analysis. Firstly, I found that more than half of cooperatives analysed have more cooperants, i.e. non-members than members and this brings into question the very nature of identity of such cooperatives. To capture better this dynamics, I differentiated between cooperative beneficiaries and cooperative users proposing a wider view of cooperative patrons. Secondly, I found that consolidated power structures in cooperatives result in higher economic efficiency contrary to what cooperative theory suggests on the merits of cooperative participatory model of governance and decision making. I used the absence of economic incentive schemes in

cooperatives, unclear governance and decision-making processes, lack of long term view of cooperatives, and lack of specialization in cooperatives to explain the empirical results. Thirdly, I showed that presence of social property has a negative effect on cooperative efficiency which confirmed the views put forward by representatives of the property rights school on the importance of clearly assigned property rights for efficient resource allocation.

In Chapter VII, I looked into the matter of property rights and examined this issue separately presenting findings on the channels through which currently ill-defined property rights structures in BiH cooperative sector affect their functioning. I showed that presence of social property or property with otherwise unclear status has an impact on investment decisions of cooperatives and may be useful in explaining why cooperatives in BiH appear to be short term solutions to economic problems rather than long term devices for socio-economic development.

In Chapter VIII, I examined cooperation among cooperatives and why it sometimes fails despite the obvious advantages that can be derived from cooperative network structures. In this Chapter, I argued that prior to engaging in second-tier cooperative structures, primary cooperatives have to reach a certain level of economic development themselves and need to devise clear and homogenous economic interest among the potential secondary cooperative members. Absent clear economic incentives, such structures cannot become functional. Furthermore, no social aims can be achieved if there is no common interest denominator among cooperative members. The case study of the Cooperative Business Network of BiH agricultural cooperatives was used to substantiate these claims.

The following section gives an overview of main policy recommendations that reflect on the findings presented above.

## Agricultural cooperatives: not only relevant but necessary

The relationship between agricultural cooperatives and representatives of public institutions in BiH has been a particularly uneasy one, tainted by the political structure of the country and especially tense because of the lack of key executive institutions at the state level that would bring about a unified approach to cooperative specific issues. This has in a way encouraged a separation of activities undertaken by entity governments in dealing with problems of cooperative sector. The research findings listed below show that even within a limited institutional framework much can be done through simple policy instruments to create a more enabling environment for cooperatives.

The following are the main areas where policy intervention could potentially lead to a more development oriented cooperative sector:

- There is no clear understanding in the public discourse (and more specifically, among policy-makers) of the term not-for-profit enterprise which is often used to describe

cooperatives – thus an erroneous interpretation emerges that relates cooperatives to enterprises that are unable to generate enough revenues to cover their own costs and consequently are not favoured for support in current policy outlook;

- Cooperatives and their members in general are not fully aware of development potential that lies in this business model and could benefit from additional education in terms of understanding basic cooperative principles and practices;
- There is limited or no functionality in cooperative apex organizations, and specifically at the state level;
- Overall, there is very little understanding of the widely accepted ICA principles of cooperation among the professionals in the cooperative sector, and these have not adequately been integrated into the legal framework for cooperatives in BiH (entity level laws included); Implementation of these principles is even more problematic; Understanding that the ICA principles are not a guidebook for cooperative formation but rather an advice on how to regulate country specific legal framework for cooperatives, additional amendments to the General Law on cooperatives could mark a positive move in this regard as clarification regarding membership requirements and governance processes could indeed clarify the understanding of cooperative identity.
- Further to the previous point, currently existing laws fail to define in strict terms who can and who cannot become an agricultural cooperative member. As a result, there are numerous instances where people who do not own land appear as cooperative members simply to satisfy the legal requirement related to the minimum number of members necessary to set up a cooperative. Further legislative work could bring much desired clarity if it introduced a term of ‘multistakeholder cooperative’ and regulate real life examples of such cooperatives accordingly.
- Many cooperatives are just cooperatives in a name, no real substance in cooperatives that signals a thorough understanding of cooperative way of doing business; examples include many family-cooperatives (no real communal effect of their activities); cooperatives with few members but many cooperants in which case cooperatives behave just like any other firm in the market towards cooperants in trying to cut their costs by overexploiting cooperants’ potential; clearer terms of exchange need to define the relationship with and amount of production that can be contributed by cooperants to the cooperative. Additionally, there is a need to either relax the conditions for registration of private firms or make the registration of cooperatives stricter in order to prevent many private businesses registering under the cooperative name.

The problems uncovered through this research suggest that there is a significant space for policy action in terms of recognizing the current problems and introducing policy instruments that would make the cooperative model more appealing to farmers. Much can be done by simply streamlining the legislation in the cooperative sector, and providing an official interpretation of the 2003 General Law on Cooperatives.

By insisting on harmonization of laws throughout the country decision-makers could create a more stable and unified legal environment for cooperatives, making their investments safer and reducing the overall systemic insecurity. Especially if the status of the 'social property' was to be resolved in favour of cooperatives, an important obstacle for reform and development in the sector would be removed. This research found that cooperatives that have property with unresolved status are indeed unable to plan and invest in their development. While this research focused on studying only active cooperatives with social property, policy would do well to enable those inactive cooperatives to restart their activities again once the cooperative ownership is formally recognized or to simply transfer currently locked property to more productive uses.

An area where three existing cooperative associations could enhance the working of the cooperative sector is in the provision of extension services, including the provision of legal counsel and organizing of educational trainings for cooperatives. So far, these services are provided only occasionally and predicated upon the existence of donor funds aimed specifically for the provision of extension services. Much of the donor aid has phased out, and cooperative associations have not been able to supplement it with some other sources of funding. Furthermore, the cooperation of the cooperative associations with neighbouring countries' cooperative associations is rather limited and reduced to joint conference organizing with little or no collaboration in productive activities. All three cooperative associations are seriously understaffed, and in terms of management function in line with the constitutional structure of the country. The umbrella association, Cooperative Association of BiH, has only three employees, one from each ethnic group and they rotate in the position of the director. There is no operational staff employed. The situation is slightly better in the cooperative associations at the entity level but not sufficiently so. Therefore, strengthening the capacities of cooperative associations would certainly contribute to making the cooperative sector a more serious market player, and especially in the eyes of the government institutions.

Against the background of all the challenges cooperatives face in the Bosnian post-conflict, post-socialist and transitional context, three key obstacles to a more meaningful development of cooperative sector in BiH stand out: externally, social property with unresolved status and internally, dynamics between members and non-members in carrying out productive activities and better regulated practice of participatory governance model. In all three areas, a more active

policy involvement would have been a welcoming step towards recreating the cooperative model that would at once be capable of using its resources more effectively while practicing the participatory governance style. So far, this has not been possible for a considerable number of BiH cooperatives.

There has been very little coordinated action on part of cooperatives in voicing their common problems to the representatives of the public institutions, including the work done by cooperative associations. First of all, this goes to show that cooperatives do not trust in the ability of the system itself to resolve the troubling issues, and secondly, that they lack the capacity to pursue the matter further until all legal means have been exhausted.

At the same time, it must be noted that communication from government to cooperatives has not been satisfactory either. Currently existing subsidy programs do not appear to be tailored in a way that reflects a serious determination of the government(s) to invest in development of cooperatives. In that sense, cooperatives are rather marginalized, pushed aside as socialist leftovers that will eventually disappear. Yet, and despite the agonizing context, they do remain an actor in agricultural market. If there was a way for government institutions to recognize development potential of cooperatives the subsidy funds could be put to a more productive use through directing them at creating a more secure investment environment, reducing the barriers to entry or to exit from the market, facilitating the land market dynamics and finally making sure that the existing state level laws are not being violated by entity laws, especially if such violation produces unbearably high costs to cooperatives.

Cooperatives are different from conventional enterprises and corporations. Their difference is part of their cooperative identity and it is to be sought not in comparing economic aspects of cooperatives to conventional firms but in highlighting the communal contribution created through their ability to foster social trust and sustain effective growth and development. Clearly articulating and understanding cooperative identity and development potential of cooperatives is especially important for cooperatives that have had a history of existence during socialist times and that, in the face of new socio-economic circumstances, have to redefine their role in a society. Much of the current scholarly debate on viability of cooperatives focuses on their economic functions, and uses cooperative structures as a sole source of cooperative distinct nature, while the very essence of cooperative identity is at danger in some parts of the world mostly because that very identity has been lost in transition from one economic and political system to another and no serious efforts at restoring it were ever attempted. Therefore, more scholarly emphasis is needed on studying the content of cooperative processes both internally and externally rather than cooperative structures, and this, I believe, is something the whole cooperative movement would benefit from in the long run.

As it was showed throughout the thesis, BiH society is particular political and economic context in which social fabric has been shattered by violent conflict and which, as a result of that, lacks basic trust among individuals and between individuals and formal institutions. With fragile social relations and low levels of generalized trust, the problems in cooperative sector greatly mirror the problems in society as a whole. However, cooperative model has showed surprisingly high levels of resistance to various crises elsewhere in the world and that gives hope in the ability of the model itself to affect the overall transformation of communities and perhaps raise levels of practicing economic democracy in local development. For this to happen, a number of conditions must be in place. The path of cooperative transformation from short term to long term mechanism of rural development will most certainly require reforms in their institutional environment but also profound changes in how cooperative processes are understood, practiced and valued as part of the cooperative identity.

# Appendix I

## Survey of the Cooperative Sector in BiH<sup>62</sup>

### GENERAL INFORMATION

1. When was the coop founded?
2. In which sector does the coop primarily operate (poultry, raspberries, etc.)?
3. What is the total number of founders, current members, cooperants, and full-time and seasonal coop employees?

	Founders	Current Members	Cooperants	Employees	
				Full time	Seasonal
Total number					

### ACTIVITIES

4. What are the coop's main activities? If more than one, please rank in order of importance. (i.e., does the coop serve mainly as a central buyer for cooperants, as a service provider for cooperants, or as a primary producer of products?)
- 
- 

- 5a. If the coop is directly involved in purchasing or producing products, what volume in value and amount did the coop handle for its two most important products? (See chart)

- 5b. For the coop's two most important products this year, what volume was purchased from cooperants versus produced by coop members or produced by the coop itself? If you do not have purchasing or production data, please estimate the percentage of total production for each group. (See chart)

Volume	Purchased from cooperants			Produced by coop members			Produced by the coop			Total handled by coop		
	KM	Tons/Liters	% of total	KM	Tons/Liters	% of total	KM	Tons/Liters	% of total	KM	Tons/Liters	% of total
Product x												100
Product y												100

6. If involved in purchasing, which of the following statements best describes the coop's position in its area of operations for its most important crop: (Check one)

- The coop is the dominant buyer
- The coop is one of the major buyers
- The coop is a minor buyer

- 7a. How many hectares of land are farmed by founders, current members, cooperants, and the coop itself? (See chart)
- 

<sup>62</sup> This survey was created by the FARMA project staff and it was distributed to cooperative heads by an organization hired by FARMA to carry out data gathering process. The data from this survey were used for the analysis presented in Chapter VI and were supplemented by information contained in databases provided by the Cooperative Association of BiH and AFIP/APIF agencies for financial reporting to which cooperatives submit their end-of-the-year financial statements.



7b. What is the average plot size farmed by founders, current members, cooperants, and the coop itself? (See chart)

	Founders	Current Members	Cooperants	Coop
Total hectares farmed				
Average plot size				

### ORGANIZATIONAL AND GOVERNANCE STRUCTURE

8. Who in the coop is responsible for making decisions about:

Decision	Responsibility
Hiring and firing employees	
Routine purchases	
Major purchases, such as a vehicle	
Production priorities	
Profit distribution	

9. How is the cooperative manager chosen? .....
- 10a. How do new members join the coop?.....
- 10b. How much time does it usually take someone to join the coop?.....
- 10c. What is the cost for new members to join the coop?.....

### COOPERANT SERVICES

11a. To understand how the coop interacts with cooperants, please answer yes or no to the following list of activities. Does the coop:

	Yes	No	Rank
Organize meetings for cooperants			
Buy products from cooperants			
Hold classroom trainings for cooperants			
Buy products in bulk for cooperants (such as fertilizer)			
Make field visits to provide technical assistance to cooperants			
Lobby government on behalf of cooperants			
(Other: please describe)			

11b. Of those interactions, which three are the most important? (List in chart above)

### FINANCIAL INFORMATION

12a. Are your members regularly informed (by the Supervisory Committee) about coop financial information? .....

12b. If so, how are they informed?.....

12c. If not, do you provide financial information on request?.....

13. How does the coop distribute profits (% reinvested, % dividends to members, etc.)?.....

14. What percentage of the coop’s total profit goes to the single member with the largest share of total coop profit?.....

15. Since the coop is designed to be profitable for its members, its value will probably increase over time. How is that reflected in the value of membership? Are new memberships worth less than old memberships?.....

16a. What happens to the membership value when a member leaves the coop? (i.e., are their investments transferable?).....

16b. Similarly, is membership value inheritable if a member dies?.....

17. To cover the costs of running the coop, which of the following did the coop receive or use in the last year:

	Yes	No	If yes, how much in:	
			2009	2010
Member contributions				
Government subsidies				
Government-owned land	(If yes, rented or free? Circle one.)			
Government-owned buildings	(If yes, rented or free? Circle one.)			
Donor grants				
Bank loans				

18a. What were the coop’s gross receipts (i.e. revenue) in KM during 2008, 2009, and 2010? (See chart)

18b. What was the coop’s annual profit (i.e. revenue – costs) in KM during 2008, 2009, and 2010? (See chart)

	2008	2009
Annual gross receipts (KM)		
Annual profit (KM)		

**AUDITING**

19. On a scale of 1 to 10, with 1 being negative and 10 being positive, how did you feel about the recent coop audit?.....

20a. Do you regularly carry out a coop audit?.....

20b. If yes (to 21a): do you inform your members about the completed audit report?.....

20c. If yes (to 21a): do you correct any mistakes that the auditor finds in the records?.....

20d. If yes (to 21c): do you inform the Association about the details of the changes?.....

## Appendix II

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### Social property in cooperatives<sup>63</sup>

1. When was your cooperative formed?
2. How many founding members are still cooperative members?
3. What is the main area of your activity? Has it changed over the years?
4. What was the structure of cooperative property at the time of its formation?
5. Did members need to bring in their private property once they joined the cooperative?
6. When did you 'acquire' social property?
7. How did you use at first?
8. How do you use it now?
9. Do you find social property to be less efficiently used compared to private property of members?
10. What percentage of your overall property could be considered social property?
11. When did you first face problems with social property?
12. What kind of problems were they?
13. Did you attempt to register it in local courts as cooperative property? Before the end of war? Between 1995 and 2003? Or after 2003?
14. Did you receive any legal council from cooperative associations with regards to handling this type of property?
15. How has the 2003 General Law on cooperatives affected the status of this property?
16. In terms of protecting the status of this property, do you see that entity laws prevail over the state level law at local courts?
17. Do you currently have any loans?
18. Do you receive government subsidies or any other considerable contributions from development agencies?
19. Has any of your property been acquired by any level of government and registered as state property?
20. If yes, have you attempted to go to court and regain control and ownership rights over this property? What were the costs involved in this process? For cooperative?
21. Did you succeed in gaining back the control over property?
22. What do you think are the reasons for the existence of so many different laws that treat social property?
23. How does the existence of social property in your cooperative affect your ability to work?
24. Has anyone from inside the cooperative attempted to sell or 'privatize' this property?
25. Do you know of any cases where this happened?
26. What were the legal consequences?
27. How do you think the presence of social property affects the size of your membership?
28. How does it affect your investment behavior? Growth of your cooperative?
29. How did you generally use gain generated through use of social property? Was all of it reinvested back in cooperative? Or shared among members?
30. How do you think this issue can be best settled?

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<sup>63</sup> The information gathered through this questionnaire were used for the analysis in Chapter VII.

# Appendix III

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Establishing a second level cooperative in BiH: potential and motivations<sup>64</sup>

## I GENERAL INFORMATION

1. Name and regional location of cooperative.....
2. When was a cooperative founded; What is the current number of members and cooperants associated with cooperative? Year: ..... Members:.....Cooperants: .....
3. What is a subsector of cooperative's primary activity (for example dairy, fruits and vegetables, aromatic and medicinal plants)  
.....

## II ACTIVITIES

4. Rank in order of importance the activities your cooperative engages in. Use number 1 for the most important activity and number 3 for the least important activity:  
 Primary production  
 Purchasing products from members and cooperants  
 Processing activities
5. Rank in order of importance the services your cooperative provides to its members and cooperants using number 1 for the most commonly provided service and number 8 for the least commonly provided service:  
 Organizes regular meetings for members and cooperants;  
 Purchases products from members and cooperants;  
 Provides marketing services for products of members and cooperants;  
 Organizes educational seminars and trainings for members and cooperants;  
 Provides technical and expert advice to members and cooperants;  
 Negotiates market placement of products for members and cooperants;  
 Assists in purchasing production inputs for members and cooperants;  
 Helps find additional financial means for development of cooperative (like government grants, international organizations' grants etc)

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<sup>64</sup> The information gathered through this questionnaire were used for the analysis presented in Chapter VIII.

### III EXPERIENCES WITH ESTABLISHING AND JOINING SECOND LEVEL COOPERATIVES

6. Rank in order of importance the services and activities that in your opinion should be provided by a second level cooperative. Use number 1 for what you deem to be the most important service and number 11 for what you consider the least important service:

- Lobbying of government institutions on behalf of its members;
- Reduction administrative costs associated with running a primary level cooperative;
- Providing common marketing services for its members;
- Providing a range of legal services including legal advise on issues pertaintint to property;
- Helping set up and develop processing and storage capacities for its members;
- Providing help with financing the purchase of production inputs;
- Assisting in finding market placement for the products of its members;
- Applying on behalf of its members for development projects financed by the EU's pre-accession funds and other available development funds;
- Setting up and managing the savings-and-loans fund for its members;
- Organizing the purchase of products from its members;
- Other. Please state:  
.....  
.....

7. Has your cooperative ever been a member of a second level cooperative? If yes, please state the name of the cooperative and period of membership.

- Yes  
.....
- No

8. If your cooperative has never attempted to join a second level cooperative, could you please rank in importance the reseason explaining your decision not to join. Use number 1 for the most important reason and number 5 for the least important one:

- Lack of information on the existance of such cooperatives;
- High costs of becoming a member;
- Lack of belief that such cooperatives are necessary at all;

Lack of trust in other cooperative members;

Other. Please state:

.....  
.....

9. In your opinion, who should sit on the management board of a second level cooperative (mark only one answer):

Representatives of member cooperatives;

Externally appointed management consisting of non-cooperative members;

Representatives of the entity level cooperative associations;

Other. Please state:

.....  
.....

10. In your opinion, how should the management of a second level cooperative be elected?

.....

11. Should all members of a second level cooperative have the same voting rights (one member, one vote)?

Yes

No

12. If no, do you think that members contributing more product for longer time and at a higher scale should have more control rights?

Yes

No

13. In your opinion, how should a second level cooperative finance its core activities?

Membership contributions;

Generating its own funding through its activities;

Borrowing capital on the market

Other. Please state:

.....  
.....

14. If there were to be an organized attempt to establish second level cooperatives on the territory of BiH how, do you think, it should be organized:

Based on the territorial principle (each economic region should have its own second level cooperative);

Based on the functions and activities it should provide (there should be cooperatives specialized in marketing, processing, input purchase, etc.);

Based on the subsector of production (a coop for dairies, meat, fruits and vegetables, etc.);

Some combination of the above;

Other. Please state:

.....  
.....

15. Agricultural cooperatives in BiH exhibit little readiness to establish and join second level cooperatives. Why do you think this is the case? What of the following you find to be the biggest obstacles to establishing second level cooperative? Rank them so that 1 signifies the most important factor and 5 the least important one:

Lack of trust in other cooperatives;

Unstable institutional environment;

Unclear role of second level cooperative;

Lack of trust in members of other ethnic groups;

Cooperative Association of BiH unfit to lead the project;

16. Are there any other obstacles you would like to elaborate on further?

.....  
.....  
.....  
.....

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