

## Legal and economic challenges before agricultural integration: from cooperatives to associations

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### Abstract

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The purpose of this publication is to explain current economic and legal problems which face existing agricultural associations in Bulgaria. The study presented relies on a mix of theories related to legal and economic aspects, thus analyzing: 1) the historical path of development of organizational forms of Bulgaria's agriculture; 2) circumstances creating the conditions for integration; 3) integration in the various organizational forms as well as upcoming controversial effects on the lateral and vertical organizations; 4) agricultural contractual agreements, as a specific form of integration of the organizations defining the role of modern agricultural associations and their influence on resource allocation; and 5) comparison of the coordination structure of the agricultural associations with other agricultural organizations, including the manner and number of their transactions. The framework of the associations as a form of organization creates additional incentives for economies of scale and opportunities for indirect transfer of transaction costs on one hand but could be a burden on other subjects. Legal solutions to improve the legal framework are presented.

**Keywords:** Agriculture Cooperations; Associations; Hybrid Organizations

### Introduction

Since the third Bulgarian state in 1878, agricultural organizations have been mentioned in Bulgaria. At that time, the first formal commercial organizations with corporate character and agricultural cooperatives were established. During this period, the country's agriculture was small and highly fragmented (Penchev, 2019). The forms of cooperatives played an important role in consolidating production factors in agriculture. Around 1945, 6455 existing cooperatives were grouped into 15 branch unions with 993.000 members, processing agricultural land and producing 70% of the national turnover in agriculture. By 1951, the number of members of these organizations increased to 1.2 million (Draganova, 2002). During the "communist age" (1944–1989), the Bulgarian agricultural organization was restructured. The state ownership of the agriculture sector featured

highly centralized management after collectivization in the 1950s. Cooperative farms proliferated across the country. In the 1970s, they were consolidated again. Through horizontal mergers, large industrial and agricultural productions known as agro-industrial complexes were established.

Cooperative farms, specifically labor agricultural cooperative farms and agro-industrial complexes (APCs), represent significant organizational structures. According to Taganui (1991) APCs operate on the principle of horizontal integration. In the 1970s and until the mid-1980s, the 744 cooperative farms in operation transformed into 161 APCs. These APCs typically employ an average of 6.500 workers and cultivate an average of 27.4 thousand hectares. These organizations also had a greater potential for economies of scale. With the help of direct and indirect support. For a detailed analysis of the structures in Bulgarian agriculture, see Doitchinova, Kanchev & Miteva, 2005.

During this period, direct support is based on: (a) Retention of primary production factors – due to the absence of a market for agricultural land, wages in agriculture are determined administratively, but their growth is maintained; (b) Administrative deployment of agro-specialists in villages for a period of at least 5 years, as well as the construction of structures at the expense of the state budget – including reclamation, transport facilities, etc.; (c) The utilization of scientific advances takes place at virtually no cost to these undertakings. Swain (2001), describing similar structures for Poland, argues that their success is built on extremely easy access to capital.

Bulgarian agriculture and its manufacturing volumes experienced growth. Up until 1989, Bulgaria ranked among the top in the world regarding the volume of production of agricultural commodities, despite having a state system of agricultural organization of “bipolar” type (Draganova, 2002), consisting of either huge industrial complexes or subsistence farms. compares the organizations in the period 1944–1989, noting that Bulgarian organizations fall into only two types: huge industrial complexes or subsistence farms.

During its transition from a communist to a market-oriented economy, Bulgaria undertook an agricultural reform in two directions: (a) Restitution of farmland (1991) to its real owners before collectivization. (b) Liquidation of the old centralized agricultural organizations (1992), replacing old-type collective farms with private agricultural cooperatives and fostering the development of new market forms.

The strong fragmentation of resources led to a reduction in the use of agricultural land and the production capacity of organizations at the beginning of the transitional period. Over 2 million “fragmented” agricultural properties existed from 1990 to almost 2007, resulting in a very low agricultural surplus. Fragmentation of property rights also contributed to the devaluation of agricultural farmland prices, along with difficulties in accessing foreign capital for agricultural entrepreneurs. This significantly increased the relative size of transaction and internal corporate expenses. Low income from land and limited market exchange scale had adverse effects on related markets.

In Bulgarian conditions, the restitution of agricultural lands operates in tandem with classical forms of inheritance. However, one restored property may end up having more than 20 co-owners, fragmenting the production factor and increasing both production and transaction costs. Despite these challenges, there are some positive examples. In Northern Bulgaria (Dobrudzha), individual players have gained market power through successful management of literal agreements, particularly among cereal producers. Similarly, some players in the wine industry have developed resource-product chains

(RPCs) by acquiring agricultural land for their own production and sometimes smaller production structures.

During the period from 1992 to 2000, Bulgaria eradicated the old centralized agricultural organizations existing before the transition. However, a resurgence of agricultural cooperatives began on the sites of the old collective farms in most cases. This led to the introduction of a new type of relationship, emphasizing balance and non-capital ownership, particularly evident in the typical cooperative form of organization. According to Suchon (2019), in Poland, the development of cooperative forms in agriculture was often motivated by ideological reasons, especially in the 1990s.

Despite the establishment of an annual average of 600 to 800 new agricultural cooperatives since 1989, reaching 3.268 in 1998, with 234 cooperative members and an average size of 742.5 ha of cultivated land, their significance for agriculture began to diminish. The main issue was the coordination of hybrid functions within these organizations, leading to challenges in fairly distributing residual property rights between managers and members. Swain (1998) notes that cooperatives often “lose their shape” compared to companies.

The transition from non-market to market economy principles, following the liquidation of old organizational structures and the redistribution of property rights, resulted in some new organizations operating at very low levels of production potential due to limited integration. Ahead of its accession to the EU, Bulgaria saw the emergence of the first farmers’ associations even before 2007. These aimed to unite stakeholders and maximize activity, including the integration of subsidies received per unit area. Concurrently, the country embarked on an intensive consolidation effort to strengthen production factors. Since 2011, trusts have been operating on an investment basis, focusing on the management and sale of agricultural land in Bulgaria.

Integration primarily occurred on a horizontal basis, posing challenges for other economic actors’ access to rights and resources. Political goals related to increasing the individual efficiency of farmers, as formulated by the Common Agricultural Policy (CAP) and Art. 39 (1) of the Treaty on the Functioning of the European Union (TFEU), led to an institutional trajectory in Bulgaria facilitating integration opportunities based on resource consolidation. In practice, groupings were formed to enhance organizational potential, and agricultural lands were consolidated, sometimes by administrative order. These concentrations were primarily associated with the primary production factor of farmland (Norrer, 2019).

Hidden vertical integration and horizontal mergers within trusts managing resources reshaped the objectives of

horizontal management structures, while non-market substitutions associated with the production factor facilitated the development of agricultural organizations with growing market power. The number of trusts for agricultural land management decreased from 67 to 5, with grain producers controlling over 80% of fertile arable land. Agricultural associations were not exempt from these processes.

Integration occurs at multiple levels, including group level, hierarchy within groups, and resource consolidation. It determines an organization's development capacity, forming the foundation of each Resource-Product Structure (RPS). The related research aimed to assess how Bulgarian agricultural associations were established and their influence on integration: (a) Organizational forms of the associations and their members; (b) Coordinating their structure; (c) Legislation impacting the organizational structure, and (d) Incorporation and stability of markets regarding the fitness of associations for different levels of resource production chains (RPCs).

## Materials and Methods

The study utilized various methods: a retrospective analysis for describing organizational forms, a historical approach for analyzing legal forms of RPCs, and a Discrete structural analysis (DSA) to clarify economic system components (Williamson, 1991). The comparative institutional analysis explored alternatives and system improvement recommendations (Koteva et al., 2022; Bachev et al., 2020; Bachev et al., 2021).

## Results and Discussion

### *Theoretical mix of the organization and integration*

One theory regarding the term "organization" presents a dualistic perspective. In its orthodox interpretation, an organization functions akin to a company, wherein entrepreneurs enhance their activities by efficiently controlling and optimizing internal and external factors. The owner of assets, guided by rational choice and objective information related to equilibrium prices, plays a pivotal role in this organizational setup, resembling a technological function (Coase, 1992; Demsetz, 1983).

However, according to other scholars such as Posner (1979) and Gilson (1984), the economic and legal nature of an organization is conditional. Legal and economic institutions are viewed as complementary. Integration of common rules reconciles public and private interests, forming a unified framework with numerous, sometimes conflicting subjective rights. This legal and economic integration shapes the

organization, influencing both internal and external, market and non-market effects (Demsetz, 1967; Ortmann & King, 2007).

Organizations are complex networks of relationships, where information plays a crucial role in implementing agreements and creating opportunities for risk reduction alongside increased communication in various forms (Diamond & Maskin, 1979; Shavell, 2006; Ayres & Gertner, 1989).

Integration in public relations brings both uncertainty and clarity, leading to legal certainty in administrative actions. It should be examined for its potential to improve the environment, including measures for rectifying distribution errors and maximizing activity. Integration can be a source of enthusiasm or cost reduction for organizations, but it can also lead to low or additional public costs (Meese, 1997; Coase, 1960; Candemir & Duvaléix, 2021).

The institutional analysis considers functional connections between individuals or administrations regarding hierarchy, hybrids, markets, emphasized processes, communication/information barriers, human actions, etc. Control mechanisms and strategies to benefit from subjective rights distribution, cognitive behavior patterns, and different logical of the business goals built on contractual mechanisms are important considerations (Hart & Holmstrom, 1987; Mihailova & Yovchevska, 2023; Penov, 2023). Organizations are "multi-layered beings," balancing internal and external effects and contradictions between individual and group strategies (Hovenkamp, 2010). Organizational calculations should clarify whether integration has had a positive or negative effect (Williamson, 2002; Masten, 1998).

However, analyzing agrarian organizations has its own specificity, especially concerning decisions related to shared ownership of natural resources. The integration of agricultural organizational forms determines the links between the food production chain, farmers' incomes, and profits based on the maximization of economic rent (Gordon's Doctrine of Bioeconomics, 1954; FAO, 2003).

For hybrid organizations, there's a perception that actors with representative power manage them, often prioritizing the union's function over their roles to ensure lower total costs compared to market-type organizations (Ménard, 2004).

### *Assumptions for the integration of agricultural organizations*

The Article 12, 18, 19, 44 paras.1, 44 para. 2, Art. 49, Constitution of Bulgaria (CRB, 1991) allows the association of citizens without restricting free enterprise. Mergers occur based on equal-level workers and employers or through

membership creation in arbitrary economic organizations. While the constitution prohibits monopolies, specific deviations allow monopolies in certain sectors with restrictions.

The state has a monopoly on natural resources (Art. 21 CRB, 1991), and economic activity involving nuclear fuel trade can only be conducted by the state under certain conditions. Similar restrictions apply to the country's currency, etc.

With the adoption of the EU acquis, Bulgaria integrated the Union's autonomous order, prioritizing the individual efficiency of market participants (See h l. 39, para. 1 item 1 of the TFEU). Widespread integration, however, poses a new stimulus for organizational integration, potentially threatening competition. The Constitutional Court of Bulgaria considers freedom to conduct business directly linked to economic integration and the right of association (CCD, 1996; CCD, 1997a; CCD, 1997b; CCD, 2021).

Although business is not an absolute right, post-EU accession, Bulgarian legislation imposes minimal restrictions and very low barriers to organizational integration, particularly in resource acquisition for agricultural organizations. Restrictions on arrangements as barriers to integration are virtually non-existent, except for "joint pricing" and "membership obstacles," which have incentivized integration of producer associations and inter-branch unions.

Figure 1 depicts a nearly 70% decrease in the number of agricultural organizations in Bulgaria from 2010 to 2021, with capital companies increasing at the expense of non-equity entities, sole traders, and family farms. The decrease in the production factor can be attributed to vertical and lateral integration of organizations, as well as changes in governance structure of contract processes (Arida et al.,

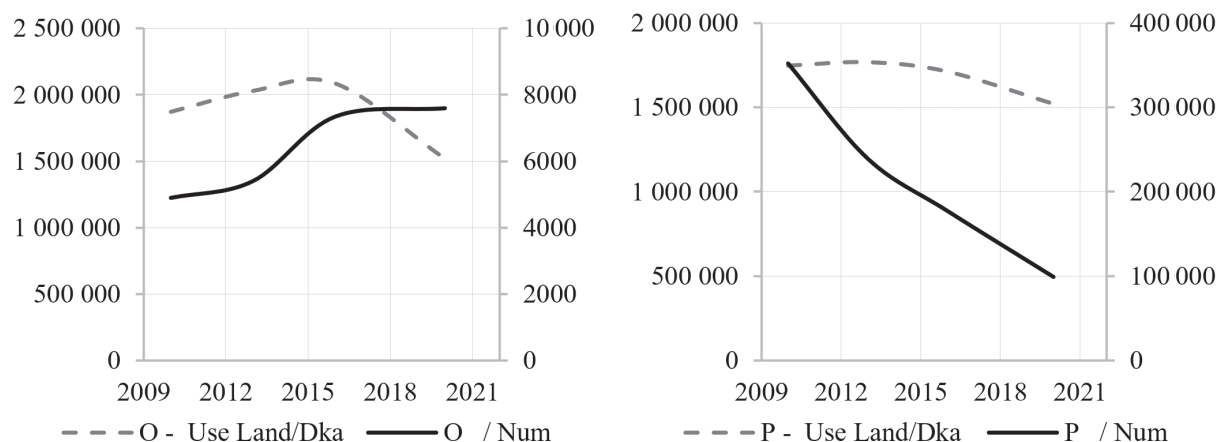
2023; Vu et al., 2020).

Nationwide integration necessitates a flexible yet complex legal system allowing for concentrations in agricultural organizations while safeguarding competition within them. However, mergers in agriculture under Bulgaria's Commercial Code may indirectly clash with the desired effect of integration laid down by Art. 39 of the TFEU, which emphasizes individual efficiency. Some provisions in Bulgaria's legislation indirectly support larger resource owners and capital-based organizations in general.

The Law on the Implementation of the Common Organization of Agricultural Markets of the European Union (LICOAMEU, 2013) and the Law on Protection of Competition (LPC, 2008) aim to prevent monopolistic or dominant positions in agricultural markets, albeit only at the national level. Local concentrations related to acquisitions remain unaffected. Tax preferences under the Corporate Income Tax Act (CITA, 2007) provide incentives for companies with special investment purposes.

Vertical integration in Bulgaria typically follows the big investor principle, often involving the acquisition of companies within specific sectors rather than mergers. However, the method of acquisition influences the subsequent formation of branch and interbranch associations, with no evidence indicating a higher value for users at different levels of RPCs (Rutten, 2003; Sarov, 2021).

Figure 2 illustrates the effects of mergers in the agriculture and food industry. Trusts managing agricultural lands decreased from 67 to 5 between 2007 and 2021 through mergers and acquisitions, controlling nearly 87% of arable land but constituting only 1.6% of total agricultural organizations. This



**Fig. 1. Total number of economic agents and resources (agricultural land)**

Notification: O = Organizations [O = COO + COM + CAO]; P = Personal [P = NT + ST]; COO – Co-operatives; COM – Companies; CAO – Civil associations and others; NT – Natural persons; ST – Sole traders;

Source: The data are from the census of the MAF, 2021

highlights discrimination at the lowest level of RPC regarding “access to agricultural land,” excluding small producers from production gradually. Large food retailers saw an increase in value from the resource-product chain, rising from 35% to 44%, while small traders, many also agricultural producers, saw a decrease from 8% to 6%. Small agricultural farm numbers have steadily declined by 72% since Bulgaria’s EU membership, indicating their exit from the market. Efficiency along the chain decreases and concentrates on both ends, often owned by entities outside the country. Some organizations gain control over resources, while others dominate commodity market value, though some argue the integration’s negative effects are merely “populism” (Shapiro, 2018).

#### *Agricultural associations and organizational calculations*

With the Commercial Act, 1996 (enforcement in 1991), private entities regained the ability to conduct economic activity, including agriculture. Companies were granted status upon request and registration, with a different procedure to protect smaller food producers from unnecessary costs. Hybrid groupings aimed to govern individual or group production and trade, and public and private functions, reducing duplication or contradictions and lowering agent costs. These forms declared reduced commercialism with differentiated formal power centers to avoid duplication. In the EU, there are approximately 3.400 agricultural associations, while Bulgaria has only 32 recognized farmers’ associations and 15 registered interbranch associations under Regulation EU (1308/2013) of the European Parliament and of the Council of 17 Dec.2013. See the associations registered on the Ministry of Agriculture’s website in the table in the Appendix.

The establishment of new organizations involving notaries, lawyers, banks, agricultural and tax services, and some administrative actors to combine public and private functions may not always strike a balance between individual and organizational objectives. In some contracts, such as those under Article 37 c of the Law on the Ownership and Use of Agricultural Land (1991), the number of participants in hybrid functions can reach 18, leading to high total transaction costs due to competition in exercising rights (Figure 3). However, property rights in hybrid organizations are capitalized from control and information dissemination. Governing joint functions prove challenging for fair distribution. The question remains whether this integration fosters a favorable business climate for all players in agriculture.

In practice, information in documents is used for acquiring property rights by some hybrid participants. For instance, the same service may be offered at different prices for varying periods, leading to fragmentation that may not directly affect RPCs at first glance.

Figure 4 illustrates that non-productive growth, particularly of the social type, is outpacing productive growth. Profit is increasingly based on rent rather than production. When examining contractual forms in agriculture, it’s important to note that multilateral, unfinished contracts are prevalent compared to other industries, although their share is decreasing, even in cases of sales or leases with numerous co-owners. The number of hierarchies related to administrative distribution of rights is increasing.

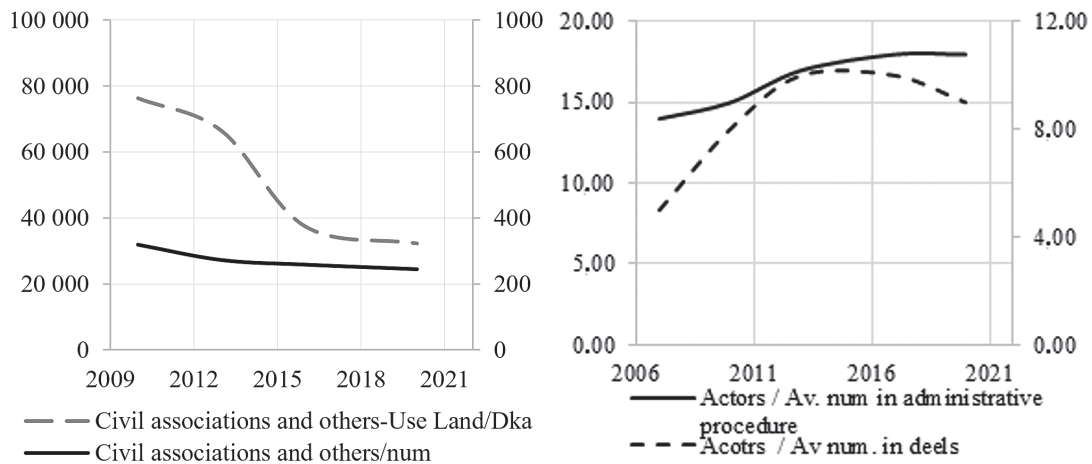
As depicted in Figure 5, DSA reveals a trend where both large and small organizations are relying less on purely physical transactions. E-transactions are gaining importance, particularly for large organizations, with the trend deepening.



**Fig. 2. Agricultural large and small organizations**

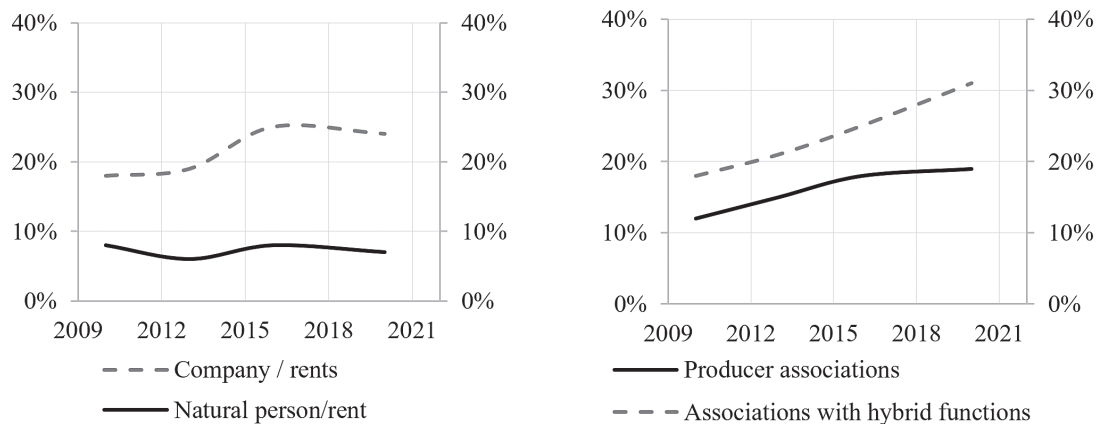
Source: own research





**Fig. 3. Agricultural Associations, Hybrids and other actors/ land use**

Source: own research



**Fig. 4. Agricultural actors: /rents**

Source: own research

While smaller companies still rely on physical transactions for an average of up to 2.5% of their turnover, the total number of transactions is increasing. There's a rise in physical transactions related to actual movement, achieving economic and legal goals. Following 2020, there's a decrease in total transactions in large associations but a sharp increase in surveyed smaller companies.

The coordination structure of the agricultural sector speaks of a high degree of fragmentation and "complex" agricultural contact. The latter is not suitable for all subjects, which means high communication risks and an increased level of activities necessary for adaptation, especially for smaller organizations.

Figure 6 indicates that there's an increase in total transactions in both large and small organizations in the short term.

Organizational calculations establish new levels of eco-

nomics. The DSA compares alternatives in and under the contract and assesses both non-activity and activity such as transactions that should be reported to agricultural associations. However, smaller economic participants experience a continuous rise even when larger ones show some slowdown in increased costs.

## Conclusions

The legislation aims to accelerate both vertical and lateral integration, driven by corporate organizational principles and incentives for integration. Positive integration analysis must acknowledge the negative effects on competition and adaptability for smaller organizational forms.

The transactions increase inversely with the number of organizations, while the total number of farming subjects de-

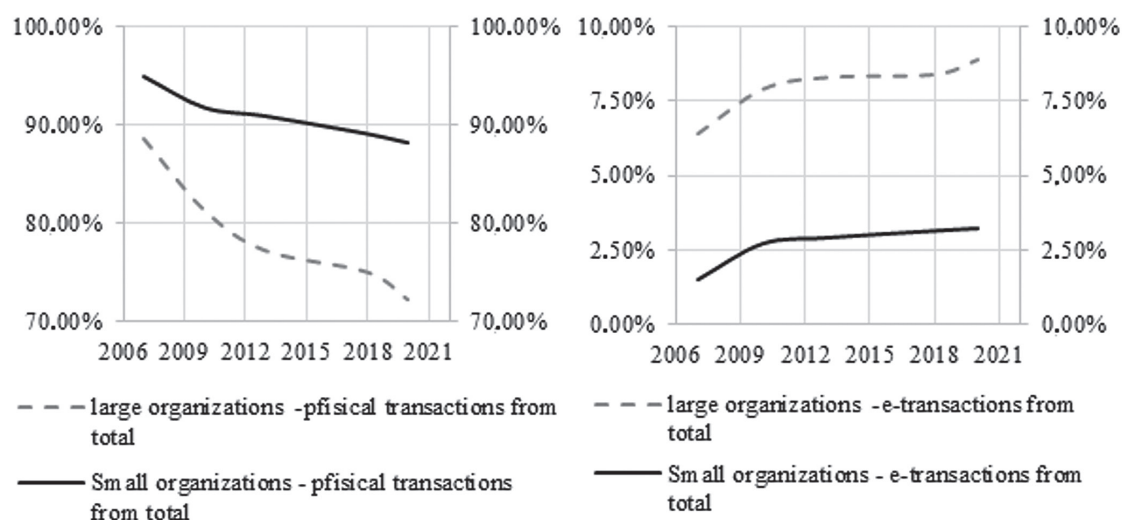


Fig. 5. Transactions: small organizations and agricultural associations

Source: own research

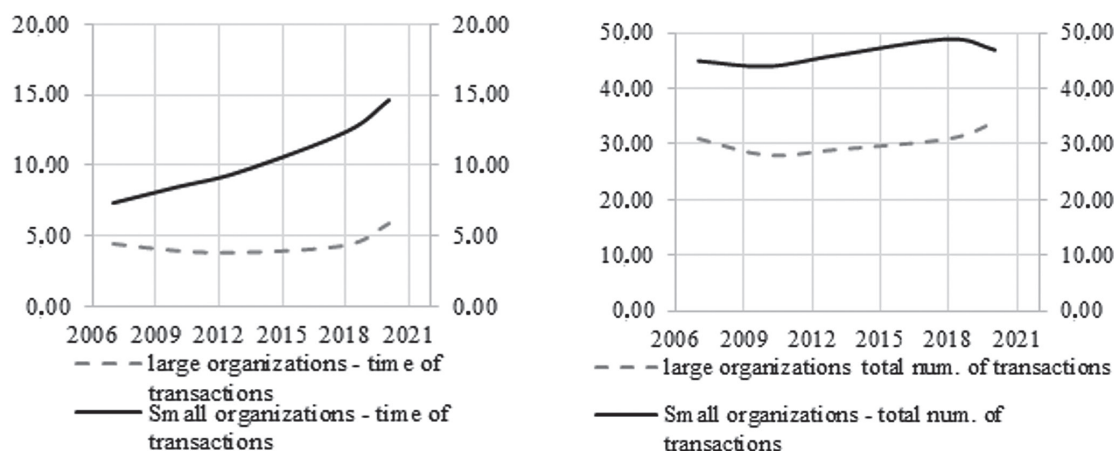


Fig. 6. Time of transactions and number of transactions

Source: own research

creases. Associations with hybrid integration forms of farmers compared to those intending to decline production exhibit indirect cost transfer from larger to smaller agricultural players.

The large players, leveraging their association power, aim to accelerate integration, excluding manual labor-dependent entities (Bilenko, 2022). This exclusion challenges smaller organizations' resource access. Labor-intensive players struggle to adapt, compounded by technology access issues, leading to decreased agricultural players and threatening market stability in the long term.

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#### Conflict of interest

Disclose the presence or absence of a conflict of interest.

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## Appendix

### Official list of associations registered in the MAFF

	Association – name	manufacturers	processors	merchants	hybrid
1	National Association of Potato Producers	x			
2	National Association of Grain Producers	x			
3	Association of Agricultural Producers in Bulgaria	x			
4	Bulgarian Farmers' Association				x
5	National Union of Agricultural Cooperatives in Bulgaria				x
6	Union of Livestock Breeders in Bulgaria	x			
7	Bulgarian Association of Agricultural Machinery Traders			x	
8	Association of Producers of Ornamental Plants in Bulgaria	x			
9	Association of Dairy Producers in Bulgaria		x		
10	National Dairy Association				x
11	Federation of Bakers and Confectioners in Bulgaria		x		
12	Association of Meat Processors in Bulgaria		x		
13	Association of Pig Breeders in Bulgaria	x			
14	National Branch Beekeeping Union	x			
15	Bulgarian Association of Greenhouse Producers	x			
16	National Synthetic Breeding Association Bulg. dairy	x			
17	Federation of Independent Trade Unions in Agriculture (FNSZ)				x
18	Bulgarian Association of Grain and Feed Traders			x	
19	National Sheep Breeding Association	x			
20	“Bioselena” Foundation for Organic Agriculture				x
21	Association for Breeding the Black and White Breed in Bulgaria	x			
22	Union of compound feed producers	x			
23	Union of Poultry Breeders in Bulgaria	x			
24	Union of Fruit and Vegetable Processors in Bulgaria	x			
25	Union of Foresters in Bulgaria	x			
26	Bulgarian Pepper Association	x			
27	Branch Chamber of the woodworking and furniture industry		x		
28	Association “Bulgarian Association of Raspberry and Berry Growers”	x			
29	Association of agri-environmental farmers	x			
30	Bulgarian Plant Protection Association				x
31	Association of producers of vegetable oils and oil products in Bulgaria		x		
32	Campaigns and activism for animals in the industry				x
	<b>Total</b>	<b>18</b>	<b>5</b>	<b>2</b>	<b>7</b>

Note: own qualification

Source: MAF, 2021