

Opportunism in agricultural cooperatives in Greece

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Abstract: *This paper compares the new institutional economics literature on agricultural cooperatives with their actual operation in Greece. The key contrast revealed by the comparison concerns the role of opportunism. New institutional economics explains cooperatives in terms of their ability to combat external opportunism, subject to the constraints of internal opportunism. In contrast, in Greek agricultural cooperatives internal opportunism is shown to inflate the formal organizational structure and to lower the cooperative's effectiveness in serving its members. The paper discusses some of the theoretical, policy and practical implications of this argument.*

Keywords: *leadership; cooperatives; opportunism; Greece*

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Agricultural cooperatives have been an important subject of new institutional economics scholarship. New institutional economists have explained agricultural cooperatives, just like any other institution, in terms of their ability to economize on transaction costs (for example, Williamson, 2004; Menard, 2004). Economizing on transaction costs, in turn, means reducing the scope of the opportunistic behaviour of relevant actors (Williamson, 1996). Agricultural cooperatives perform this function by counteracting the opportunistic behaviour of farmers' contractual partners in the upstream and downstream segments of the agrifood chain (Bonus, 1986; Staatz, 1987).

At the same time, new institutional economists point out that opportunism exists within cooperatives as well, in the form of opportunistic behaviour of cooperative members towards each other (Williamson, 2004). Because of their internal opportunism, agricultural cooperatives are afflicted by so-called incentive problems (Williamson, 2004; Cook, 1995; Borgen, 2004) that adversely affect their competitive survival. Due to these problems, agricultural cooperative members are discouraged from investing significant risk capital (Cook and Iliopoulos, 2000) and are unable to make efficient collective decisions (Iliopoulos and Hendrikse, 2009). It is primarily because of these problems that new institutional economists have

designated the property rights of traditional agricultural cooperatives as 'vague' and 'ill-defined' in comparison with the fully delineated private property rights of the investor-oriented firm (Cook and Iliopoulos, 2000).

External and internal opportunism obviously have the opposite implications for determining the expedient range of cooperative activity. While counteracting external opportunism provides a major rationale for this activity, the range of this activity is limited by the extent to which cooperative members are mutually opportunistic. The mutually balancing effect of internal and external opportunism is at the centre stage of Hansmann's (1996) 'enterprise ownership' approach, which differentiates between 'market contracting costs' and 'ownership costs'. According to Hansmann (*ibid*), cooperatives are important in the agrifood chain precisely because farmers face significant market contracting costs (due to significant external opportunism) while incurring relatively low ownership costs (due to relatively insignificant internal opportunism).

This paper uncovers a new facet of the significance of internal opportunism in agricultural cooperatives. Paradoxical as it is, the paper's key contention is that internal opportunism may be an important rationale for the existence of agricultural cooperatives as well as a likely reason for the inflation of their formal

organizational structures. In the new institutional economics literature, internal opportunism has traditionally been discussed with reference to managerial staff (Fama, 1980; Fama and Jensen, 1983; Vitaliano, 1983). In addition to this type of opportunism, this paper introduces opportunism practised by members of the board of directors, and particularly by chairmen of the board. The motivation for this suggestion is empirical and is specifically inspired by the experience of modern agricultural cooperatives in Greece. In the context of the European agricultural cooperative movement, Greece is remarkable since no other European country has so many agricultural cooperatives that produce so little value for their farmer-members. For example, in 1997, turnover per agricultural cooperative (billion ECU/cooperative) was 0.0001 for Greece, compared with 0.0188 for Denmark, 0.0892 for the Netherlands, 0.1648 for Sweden, 0.0014 for Spain and Portugal and 0.0145 for France (van Bekkum and van Dijk, 1997; authors' own calculations). The number of Greek agricultural cooperatives does indeed seem to be inflated, rather than constrained, by their internal opportunism. The paper also provides empirical evidence on the operation of Greek agricultural cooperatives, with special attention given to the linkage between governmental involvement in agriculture and managerial opportunism in agricultural cooperatives. A discussion of implications for the new institutional economics theory of agricultural cooperatives, as well as for cooperative policy and practice, is then provided.

Agricultural cooperatives in Greece

This section summarizes the evolution of Greek agricultural cooperatives and the opportunistic behaviour of cooperative leaders. The first section shows that Greek agriculture was heavily regulated in the twentieth century, in line with similar trends in other European countries. The following section relates this regulation to the acknowledged problems of Greek agricultural cooperatives, such as pervasive rent-seeking and the lack of entrepreneurial incentives. The empirical evidence was gathered through a number of sources. Various published volumes provided a detailed historical account of the formation and evolution of Greek agricultural cooperatives (Klimis, 1985; Avdelidis, 1978). Additional information on the last 10 years was reviewed in the form of industry magazine articles, annual income statements of cooperatives, historical archives and various scientific and popular publications. These sources provided both qualitative information (for example, on developments in the organization of cooperatives, and problems facing them) and quantitative data (such as financial ratios).

Government regulation of Greek agricultural cooperatives: a historical background

The first modern Greek agricultural cooperative was founded in the early 1900s, but adoption of this organizational model accelerated only after 1915 when the first cooperative law was enacted (Law 602/1915). At that time, the government viewed cooperatives as a policy tool useful in addressing extreme market failures caused by asymmetric distribution of information and bargaining power to the benefit of wholesalers of agricultural

commodities (Iliopoulos, 2000). The farmers themselves saw cooperatives as the only means to overcome the extremely harmful consequences of persistent market failures. In the ensuing years, more than 3,000 local multipurpose agricultural cooperatives provided their farmer-members with credit at favourable rates, access to high-quality inputs and marketing channels at reasonable prices. In 1917, these local cooperatives started organizing second-tier, federated structures that invested in processing plants for all major Greek agricultural products. However, direct government intervention, mainly through numerous amendments to the cooperative law, began in the 1930s and continues until today. The extent and intensity of this intervention were maximized during the dictatorial regimes of 1936–40 and 1967–74, but also in the 1980s. It is worth noting that, from 1915 to 1970, 946 amendments to Law 602/1915 were passed: that is, approximately two amendments per month (Lambropoulou-Demetriadou, 1995). As a result, very few cooperatives kept focused on achieving the goals that had provided their initial founding motivation.

In the 1980s and 90s, the legal framework was modified several times. Political confrontations between board members who represented and were supported by different political parties became the norm. As a result, agricultural cooperatives shifted their focus from pursuing business goals to becoming efficient election campaign mechanisms for political parties. Two political choices caused this catastrophic development. First, political parties chose agricultural cooperatives as a battlefield for political confrontations due to the fact that farmer-members represented a significant percentage of the voting power in national elections (over 20%) and nearly all farmers were members of at least one cooperative. Second, many cooperative leaders used this development as an excuse for pursuing their individual goals – pecuniary or otherwise – even if their actions harmed cooperatives. The observed increase in memberships after 1982 may be attributed to farmers' belief that they could derive significant benefits by gaining direct access to one of the two most powerful political parties: that is, the right-wing conservative party of 'New Democracy' and the centre-left party, 'PASOK'.

Experimentation with different legal frameworks and extensive government intervention in the internal organization and business decisions of agricultural cooperatives led these organizations into enormous troubles during the 1980s and 90s. Huge debts accumulated and cooperatives' market shares in both product and input markets fell to unprecedented levels (Tsatsakis, 2008; Agrotypos, 2004; Patronis, 2002; Iliopoulos, 2000). Even worse, the dominant organizational culture within agricultural cooperatives became tolerant of internal dissent.

The pressing need for Greek farmers to deal with a number of economic problems created by an increasingly global, competitive environment in the late 1990s and the forthcoming elimination of direct subsidies by the EU forced the government to rethink its role *vis-à-vis* agricultural cooperatives. As a result, in February 2000 it enacted Law 2810, which is characterized by simplicity, generality and the elimination of government intervention. After 2000, however, the government still

kept intervening in cooperatives' affairs (Ana-Mpagi, 2006). In the same period, decreasing world commodity prices, coupled with dramatic increases in input prices, unravelled most cooperatives' inability to protect the income of their farmer-members, let alone to capture added value from other vertical stages of the supply chain. Currently, agricultural cooperatives are faced with major challenges and critical strategic dilemmas (Iliopoulos, 2002).

The opportunistic behaviour of agricultural cooperative leaders

The long history of Greek agricultural cooperatives is characterized by periods of business successes interrupted by market- and incentive-distorting government interventions, along with organizational failures ignited by the rent-seeking behaviour of cooperative leaders. In the preceding section we discussed how government intervention had resulted in severe organizational inefficiencies. Such intervention, however, might not have been possible without the consent of some of the leaders of agricultural cooperatives. The simultaneous negative impact of these two behaviours explains the paradox: among EU member states, Greece has the highest number of agricultural cooperatives but the lowest value produced per cooperative. The number of active agricultural cooperatives is much lower than reported in official statistics (although these have not been published since the mid-1990s), a fact that justifies the low value produced per cooperative (Demakis, 2004; Petalotis, 2004). Indeed, many existing cooperatives do not serve any real business purpose (Papachristou, 2009). But why is this?

The voting system adopted by cooperatives may help in answering this question. According to the standing (but also the previous) Greek cooperative law, the members of local cooperatives elect representatives to the board of a second-tier, federated cooperative (called an 'association'). Subsequently, these board members elect representatives to the board of PASEGES (an umbrella organization representing all second-tier, federated agricultural cooperatives). This organization is not involved in any business activity as its primary role is to represent federated agricultural cooperatives and lobby for their positions in national and European policy-making institutions. It is this proximity of PASEGES to policy makers that makes serving on its board a highly desirable position. Access to personal benefits in various forms, the ability to influence important resource allocation decisions, and the increased chances of receiving support from a political party in national or EU parliamentary elections are (among others) some of the advantages associated with serving on the board of PASEGES. Being elected to the board of an association or even a local cooperative, which is a prerequisite for election to the board of PASEGES, also provides a farmer with access to local and national policy makers and thus to the above-mentioned benefits. The CEO of a federated cooperative argues that:

'After working 20 years for cooperatives, I am certain that the establishment of 6,000 or 8,000 local agricultural cooperatives was a political decision. That

is, politicians decided that they need 10,000 local party leaders. . . How couldn't they foresee that an illiterate farmer in his 60s who serves on the board of a local cooperative will very quickly realize how lucky he is to run the business on his own, without the help, and thus control, of a professional manager. This farmer will then support the local party leader in the elections for the association's board. Subsequently, the association's board supports the local candidate in the elections for Parliament members. After being elected this member of the Parliament will, in turn, support the farmer to be elected on the board of the local cooperative; this process is repeated for decades. The member of the Parliament helps young people from the village or relatives of the farmer to find jobs. Actually the local cooperative is run by both its board and politicians, which results in the co-op's collapse.' (Demakis, 2004, p 69)

The observed close and mutually beneficial relationship between local or national agricultural cooperative leaders and politicians is manifested in several ways. First, in recent decades several leaders have used their position as a stepping stone to a political career in either the national or the EU parliament (Demakis, 2004). Second, politicians can more easily influence homogeneous groups of farmer-voters. Thus they view local cooperative leaders as playing a group-forming and influencing role. Consequently, they receive support from farmers without paying the full cost associated with a political campaign, since a major part of this cost is incurred by cooperative organizations themselves.

The opportunistic behaviour of cooperative leaders, which is supported and propagated by many politicians, has resulted in various types of serious organizational inefficiencies in the form of more than €850 million (2005 estimate) in debts, low-quality products, an inability to protect members' income, very high influence and transaction costs and low investment levels (Stergiou, 2005). The consequences include lost markets and generalized public distrust of cooperatives as a sustainable business model (Demakis, 2004).

Despite these inefficiencies, local agricultural cooperatives have not responded to any of the market signals or the powerful incentives provided by the government in recent years for mergers between cooperatives (Sergaki, 2006). For example, whilst producer prices of extra virgin olive oil have been dramatically low for many years, eight federated olive oil cooperatives compete against each other in the prefecture of Chania, just one small county on the island of Crete (Oustapasidis *et al*, 2000). The situation is similar in respect of other products and regions (Kontogeorgos, 2001). In summary, the number of local and second-tier cooperatives remains high relative to the needs of farmers and market demand.

Implications for cooperative scholarship, policy and practice

How is the Greek experience of agricultural cooperatives related to the new institutional economics theory about agricultural cooperatives? This experience highlights the embeddedness of agricultural cooperatives in a broader

set of political and cultural institutions. By embracing the methodologically individualist outlook, new institutional economics arguments are admittedly constrained in fully capturing this embeddedness (Hodgson, 2004). It is evident that the transaction cost-reduction function of agricultural cooperatives, as emphasized by the new institutional economics literature, bears little relationship to the described Greek story. What is required for understanding agricultural cooperatives is an analysis of the actual motives of their real-world stakeholders, followed by the integration of the results of this analysis into a more encompassing theoretical framework.

Arguably, such a framework can be found in the multidisciplinary literature on the third sector, an institutional construct encompassing cooperatives, NGOs, social enterprises and other private organizations that subject profit making to social goals (Evers and Laville, 2004). This literature draws the important distinction between two types of economic explanations of third sector organizations: the demand-side explanations addressing the problems solved by these organizations, and supply-side explanations uncovering the mechanisms whereby these organizations actually come into existence. Similar to the new institutional economics literature on agricultural cooperatives, the demand-side explanations of third sector organizations include correcting market failure and economizing on transaction cost (for example, Steinberg, 2006). At the same time, and in contrast to agricultural cooperative scholarship, third sector organizations are often recognized to be created (supplied) for reasons that are not necessarily related to their demand-side justifications, thus casting doubts on the real-world explanatory value of these justifications (*ibid*).

As is evident in the Greek agricultural cooperatives, the distinction between demand- and supply-side explanations takes an even more dramatic turn. While the worst-case scenario for the third sector literature is a complete separation between these explanations, the Greek agricultural cooperative case suggests that supply-side explanations may directly undermine demand-side ones. Indeed, in the Greek case, an important part of the supply-side explanation is leaders' opportunism that constrains the ability of cooperatives to deliver on their demand-side missions of providing effective service to members. Thus, the Greek case demonstrates that the real-world validity of demand-side explanations, for cooperatives and third sector organizations more generally, is necessarily relative to the specified supply-side explanation. So far, the new institutional economics literature on agricultural cooperatives has been paying more attention to their demand-side explanations than to supply-side ones; the Greek case shows that the relationship between these explanations must be more balanced.

Several practical implications can also be drawn from the analysis above. First, agricultural cooperatives whose demand-side and supply-side rationales are disconnected do not add value to their members and do not address market failures posited by demand-side theorists. The congruence between demand-side and supply-side rationales can be improved by enabling cooperative members to monitor their leaders' behaviour. This, in

turn, calls for carefully designed cooperative by-laws that make it difficult for a minority of members to divert their cooperative from pursuing its demand-side goals. Furthermore, it is crucial to educate members about the contrast between demand-side and supply-side rationales for their cooperatives. Second, the number of cooperatives and the number of farmers cannot be used as a proxy for the actual representation of farmers by cooperative leaders. The Greek case shows that both of these indicators run the risk of being abused by opportunistic cooperative leaders in their dealings with governmental officials and politicians. Third, public policy support for agricultural cooperatives should be justified in terms of their real contribution to addressing market failures. Finally, development agencies and policy makers that view cooperatives as tools for achieving the goals of agricultural and rural development should be aware of the actual motives of real-world stakeholders. The gap between the demand for and supply of cooperatively provided services may be exploited by opportunistic individuals who use the cooperative organization for pursuing their own goals to the detriment of the cooperative. Selecting potential cooperative leaders may prove to be one of the most difficult tasks of development specialists.

Conclusions

This paper confronts the new institutional economics arguments about agricultural cooperatives with observations from Greece. The major contrast revealed concerns the role of opportunism. In new institutional economics, opportunism (jointly with bounded rationality) is a factor giving rise to transaction costs that are reduced by governance mechanisms, such as cooperatives. In Greek agricultural cooperatives, leaders' opportunism is a determinant of their inflated formal structures and low effectiveness in providing services to members. While certainly not irrelevant in explaining the operation of Greek agricultural cooperatives, the new institutional economics literature does not capture the whole truth about this institutional arrangement in the indicated historical context.

Further research can address this problem by differentiating between the demand-side and supply-side explanations of agricultural cooperatives, in line with the broader third sector studies literature. This literature, as well as the transaction cost-reduction accounts of agricultural cooperatives, traditionally treated opportunism as a part of its demand-side explanation. The contribution of this paper is to show that opportunism may likewise play a role on the supply side, thus undermining the demand-side explanations. Consequently, in order to possess real-world relevance, the latter explanations must be contingent on the factors that cause supply of agricultural cooperatives. For the new institutional economics literature on agricultural cooperatives, this involves the need to make the supply-side assumptions explicit; for the third sector literature, it means that the demand-side and supply-side explanations, despite their apparent separation, are generally relative to each other. The practical and policy implications of the paper are related to the necessity of

ensuring the correspondence of the demand side and supply side of real-world cooperatives. Only in the latter case can cooperatives be successful in the long run and deserving of public support.

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