International Labour Review, Vol. 131, 1992, No. 4-5

Cooperative law: An instrument for development?

Ashish SHAH *

This paper argues that legislation, used as an instrument of "social engineering", can be a catalyst in inducing or accelerating the process of development in its broader sense. In particular we shall consider cooperative law, which provides a legislative framework for the operations of cooperative organizations. The large potential of cooperatives for promoting development has already been extensively researched [1] and is borne out by practical experience with cooperatives in many countries. They have been successful in providing much needed services to their members in the fields of agricultural marketing and supply, consumer goods, housing, credit and savings, etc. In some countries cooperatives even command a major market share in certain sectors (dairy produce in Denmark, agriculture in Japan, dairy and oilseed production in India, insurance and transport services in Singapore, to name just a few examples). It follows that a law conducive to the development of cooperatives could have a strong and beneficial impact on overall development.

Cooperatives differ from ordinary businesses because they are socio-economic self-help organizations which are member-oriented in the sense that member participation is of vital importance and control is not based on the amount of the individual member's financial contribution. For these reasons ordinary company law could not provide a suitable legal framework for them: a special type of law is needed.

But what type of law? Research carried out in the field of cooperative legislation has demonstrated that excessively restrictive legislation has been a frequent cause of the failure of cooperatives.[2] The provisions of

* International Labour Office.

[1] See for example Alfred Hanel: *Basic aspects of cooperative organizations and cooperative self-help promotion in developing countries* (Marburg, Marburg Consult for Self-Help Promotion, 1992).

[2] Cf. Hans-H. Münkner and G. Ullrich (eds.): *Co-operative law in East, Central and Southern African countries: A comparative approach*, Seminar report (Berlin, German

(footnote continued overleaf)

cooperative laws in many Third World countries have impeded the sound development of cooperatives and crippled their potential. What then are the necessary ingredients of an appropriate and adequate cooperative law? Before we answer that question, it is important to reflect briefly on the way cooperative legislation is currently understood and dealt with in developing countries. This will provide valuable insights on how not to legislate for cooperatives.

1. Negative experiences in the field of cooperative law

The origins of present cooperative legislation in almost all developing countries go back to colonial times when cooperatives were introduced as instruments for increasing the production and quality of export crops, for reducing indebtedness among farmers and – more than just incidentally – to help spread the value systems of the colonial powers. The way for their establishment was prepared by enacting specific legislation based on the principle of state "sponsorship" of cooperative development; the English-speaking colonies set off down this path more than 30 years earlier than their French-speaking counterparts, which experimented for a long time with parastatal organizations promoting rural development.[3]

After independence most developing countries at first retained the cooperative laws enacted under colonial rule. The euphoria of independence and the blind faith in cooperatives as appropriate instruments for the attainment of development goals – a faith reinforced by the socialist dogma then in vogue – caused the newly independent governments to press cooperatives into service for achieving national economic and political goals, to establish large government bureaucracies for their promotion and to exercise strong guardianship over them. Thus state sponsorship gave way to state control, and cooperative legislation was modified accordingly.

The true nature of cooperatives as autonomous self-help organizations owned and controlled by their members and providing services they need was forgotten in the process. As a result a large number of legislative provisions were introduced which conform to the model of state-controlled cooperatives and run counter to everything true cooperatives stand for. Some examples of these provisions, a large number of which continue to exist in many developing countries even today, are listed below.

(a) The Registrar is given strong interventionary powers in the operations of cooperatives:

Foundation for International Development, 1981); and Hans-H. Münkner: "Practical problems of law reform in Africa with particular reference to co-operative law", in *Yearbook of Agricultural Co-operation* (Oxford, Plunkett Foundation, 1982), pp. 51-56.

[3] See Hans-H. Münker: *Comparative study of co-operative law in Africa*, Part I: *General report* (Marburg, Marburg Consult for Self-Help Promotion, 1989), pp. 26-32.

- the Registrar can change the by-laws of cooperatives on his or her own motion or refuse to register amendments of by-laws without giving any reason;
- the Registrar can force cooperatives to amalgamate or affiliate to higher-level cooperatives;
- the Registrar can appoint managers and board members of cooperatives;
- the Registrar's approval is required before cooperatives can make investments or provide loans;
- the Registrar is responsible for auditing cooperatives and for settling disputes within or among them.

(b) Massive state assistance to cooperatives is linked with corresponding state control, e.g. the State appoints managers or board members in return for state participation in the capital of cooperatives. Strong decision-making powers are vested in the Minister in charge of cooperative affairs.

(c) Cooperatives are assigned the function of promoting the interests of the community in general or society as a whole, thus blurring their profile as member-oriented organizations.

(d) Cooperatives are defined in a very narrow way allowing insufficient flexibility of organizational forms.

(e) Their sphere of action is defined from a very ideological point of view, with little mention of their economic and entrepreneurial functions, e.g. in the cooperative law of Indonesia.

(f) Lax or inadequate procedures permit the registration of pseudo-cooperatives.

(g) The marketing and supply activities of agricultural cooperatives (both primary and higher-level organizations) are restricted to acting as agents of marketing boards and other parastatal bodies.

Provisions of this sort have curtailed the operations of cooperatives and contributed to the loss of autonomy and commitment of their members. The rank and file consider such cooperatives to be organizations run by the State and remain interested only as long as they can benefit from the hand-outs the State provides. As a result, they do not feel responsible for the management and control of the cooperative. It is evident that genuine cooperative development cannot be induced without repealing the more restrictive provisions in the legislation on cooperatives and associated laws affecting them and without introducing new provisions that will stimulate their activities.

2. Necessary ingredients for an appropriate legal framework for cooperatives

State policy for cooperative development

Cooperative legislation should obviously reflect official policy on the development of cooperatives, so any discussion about an appropriate form of cooperative law needs to begin with cooperative policy.

The experience of state-sponsored and state-controlled cooperatives has been largely negative. On the other hand those cooperatives which have in general been rather successful (e.g. the credit unions) have been able to avoid undue state interference and demonstrate their capacity to mobilize local initiative and resource potential. This encourages us to propose the hypothesis that overbearing and improper state influence on the organizational and management affairs of cooperatives retards their autonomous and successful development. Any cooperative development policy should therefore clearly identify cooperatives as autonomous self-help organizations of and for their members and should categorically commit the State not to undertake any activities which may in any way infringe their autonomous operation and development. State policy should be to create a favourable socio-economic and legal framework for the growth of cooperatives as private business organizations with a social component.

In what follows we consider some of the principles and provisions it would be appropriate to include within the ambit of a cooperative law.

Preamble

The state policy discussed above should be reflected in a preamble to the law or in a separate statement of objects and reasons *(exposition des motifs)*. Clearly, all the provisions of the law should be based upon the philosophy outlined in such a policy. The preamble should briefly spell out the aims of the law, the major issues it covers, the autonomy of cooperative activities and the potential role of cooperatives in promoting development. A preamble of this kind would do justice to the development catalyst function of cooperative law.

Definition of cooperatives and cooperative principles

If cooperative legislation is really to be an instrument for development, with the manifold functions that implies, it should be characterized by flexibility. It should not be too restrictive, e.g. defining a cooperative along the traditional lines established by the colonial model, but at the same time must be absolutely clear in defining those organizations whose operations are to be covered in the law.

Today, we find a large variety of cooperative-type organizations in developing countries. Many of them are based on traditional forms of

mutual solidarity and social relations and operate according to indigenous value systems. It would indeed be a mistake for such organizations not to be brought within the ambit of the cooperative law if they so wish. Organizations of this type are thriving and include, for example, informal savings clubs in Zimbabwe, "village groups" like the Naam groups in Burkina Faso, youth groups in Benin and "economic interest groups" in Senegal and Cameroon. Such organizations have a large potential for resource mobilization and development and ought not to be ignored. The cooperative law should therefore use a flexible definition of cooperatives which can accommodate both the traditional and the more innovative organizational forms. It may be necessary, as is done in the new cooperative law of Cameroon, to make separate provision for the registration and regulation of different forms of cooperative-type organizations.

This would include the registration of pre-cooperatives as well as village groups and economic interest groups. The law should make it possible for such pre-cooperatives to attain full cooperative status if they wish to and if certain conditions are met. This flexibility will be increasingly necessary in the future since, in the wake of structural adjustments and the subsequent collapse of many state-sponsored cooperatives, we can expect to see a mushrooming of new cooperative-type organizational forms to take their place.

As far as cooperative principles are concerned, those formulated by the International Co-operative Alliance (ICA) still provide a sound basis.[4]

---

[4] The ICA is the apex organization of cooperative movements all over the world. At its 23rd Congress in Vienna in 1966 it adopted the following principles, which are recognized internationally (see ILO: *Co-operative management and administration* (Geneva, 2nd ed., 1988), p. 7):

1. Membership of a cooperative society should be voluntary and available without artificial restriction or any social, political or religious discrimination to all persons who can make use of its services and are willing to accept the responsibility of membership.

2. Cooperative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in a manner agreed by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.

3. Share capital should only receive a strictly limited rate of interest, if any.

4. Surplus or savings, if any, arising out of the operations of a society belong to the members of that society and should be distributed in such a manner as would avoid one member gaining at the expense of others. This may be done by decision of the members as follows:

(a) by provision for development of the business of the cooperative;

(b) by provision of common services; or

(c) by distribution among the members in proportion to their transactions with the society.

5. All cooperative societies should make provision for the education of their members, officers and employees, and of the general public, in the principles and techniques of cooperation, both economic and democratic.

6. All cooperative organizations, in order to best serve the interests of their members and their communities, should actively cooperate in every practical way with other cooperatives at local, national and international levels.

However, the intensive discussions going on presently among academics as well as practitioners on the subject of basic cooperative values should definitely lead to some new thinking about cooperative principles in the near future. The non-discrimination of membership in cooperatives on political, racial, ethnic, social or religious grounds or on the basis of sex has become increasingly important in the present context, as have the service orientation of cooperatives and their focus on transactions with their members. These should be rejuvenated as cooperative principles and the development of human resources in and through cooperatives should be more strongly emphasized.

Functions of the Registrar and the formation of cooperatives

The massive interventionary powers of the Registrar in the management of cooperatives need to be removed completely. He or she should be entrusted only with the tasks of registering and cancelling the registration of cooperatives as well as with ensuring that cooperatives are not violating the provisions of the law and their own by-laws.

The law should provide for a formation process which, without putting a heavy administrative and financial burden on prospective cooperatives, encourages the involvement and education of their members. Further, it should ensure that cooperatives seeking registration have the intention and the capability or potential to promote the interests of their members. The law would include provisions covering such matters as:

- the formation of a pro tem committee responsible for the education of prospective members, conducting feasibility studies, drafting the by-laws of the cooperative and discussing them with members in study groups, completing the formalities for registration;
- simpler registration criteria for pre-cooperative groups (and of village or economic interest groups);
- a system of decentralized registration, especially in larger countries;
- quick and efficient registration procedures;
- the possibility for higher-level cooperatives (if they exist) or for non-governmental organizations to assist in the formation stage and to provide support to pre-cooperative groups, *if the latter so request.*

By-laws

The cooperative law should only provide a general framework for the registration, organization and operations of cooperatives. It should ensure that basic cooperative values and characteristics are adhered to and that the interests of members and third parties (e.g. creditors) are safeguarded. Over and above this skeleton framework, all other details concerning the cooperatives' affairs should be left to the by-laws and internal regulations of

the cooperatives themselves, to be adopted and amended by the members according to their needs. However, in view of the low level of education of members in many developing countries, it may be necessary to provide for more detailed legislative regulation for a transitional period, in order to avoid educated members of a cooperative taking advantage of the autonomy of its by-laws at the expense of the other members, as has often happened in the past.

Privileges

Privileges such as tax benefits, exemption from customs and excise duties or preferential fiscal status should be granted, if at all, only selectively and for a specified period of time. Cooperatives which are already able to compete with other business organizations should be treated like any other form of business as far as privileges are concerned. Favourable treatment should be extended only to weaker cooperatives or those just starting up (the "infant industry" argument). Cooperatives performing work which in the eyes of the State deserves special recognition could be given certain benefits in the same way as other (e.g. non-profit) organizations undertaking such functions. However, the relevant provisions might be better included in the taxation law rather than in the cooperative law.

It is most important, therefore, that where it is considered necessary to grant privileges to cooperatives they should be *selective* in the sense that they are given only to deserving cooperatives, as defined in the taxation or cooperative law (e.g. cooperatives doing business predominantly with their own members, cooperatives showing a growth potential or considered to be of social utility), and *self-liquidating* in the sense that they should be withdrawn after a specified period or when certain conditions are met (e.g. once the cooperative's profit or turnover has reached a certain volume).

The issue of privileges for cooperatives is a sensitive one and needs to be handled carefully. The misuse of privileges by pseudo-cooperatives in the past – and even today – reinforces the maxim that the best way of preventing misuse of privileges is not to grant them in the first place. However, in view of the large potential that cooperatives and cooperative-type organizations possess for promoting sustainable development and for reducing the social costs of structural adjustment measures in particular, such benefits may legitimately be foreseen on an individual and rigorously selective basis.

Organization and management

The cooperative law should provide a basic framework for the different organs of the cooperative and for their constitution and functions (leaving the details to be provided for in the by-laws).

The General Meeting should be declared the supreme authority and the highest decision-making organ. The principle of democratic control and one

member, one vote in primary cooperatives should be laid down in the law. The possibility of holding area meetings and meetings of delegates in large cooperatives should be foreseen in order to enhance member participation and contribute to a better informed membership.

The Supervisory Committee should be made a mandatory organ supervising the activities of the Management Committee. Its members should be empowered to examine the books and accounts, check on finances, attend Management Committee meetings and approve certain important decisions affecting the cooperative, e.g. very large investments or decisions where the interests of Management Committee members are affected, e.g. attendance allowances for Management Committee meetings or loans for members of the Management Committee.

The term of office of Management Committee members should be limited; reelection should be allowed but the principle of rotation must be upheld. This would combine continuity with flexibility and make room for the introduction of new blood. There can be no compromise over the need for officers to be freely elected by the members and to be answerable to no one else.

Provision should also be made for the establishment of special (elected) subcommittees. This would increase member participation and provide a forum in which members could prove their abilities and fitness for election to the Management Committee. The establishment of an Education Subcommittee might be emphasized and could even be made mandatory after a cooperative has reached a certain size. The development of human resources (both members and staff) thus made possible would not only be in keeping with the social mission of cooperatives but also create a more aware membership leading to higher member participation and increased efficiency.

Details concerning the composition, election and term of office, functions, procedures at meetings, etc., of the various organs of a cooperative should be left to the organization's by-laws.

Provisions for special target groups

Cooperative law should also address such issues as non-discrimination on grounds of sex and the integration of women in cooperatives. Special provision can be made to increase their participation in decision-making by ensuring that they are represented equitably on the Management Committee and the various subcommittees. In this connection it should be stressed that existing provisions in cooperative legislation (e.g. restriction of membership to heads of households or to owners of land) and other laws (such as family law, property laws, banking laws) which restrict the integration of women in cooperatives need to be removed.

Young people could also be encouraged to participate in cooperatives through appropriate representation on the Management Committee and by

the formation of a Youth Subcommittee which would promote the formation of school cooperatives etc. Similar provisions might be included to protect the interests of the disabled. The law could also address issues such as environmental degradation (e.g. by providing for the establishment of environmental subcommittees or of cooperatives for natural resource management) and child labour (e.g. by allowing working children to form cooperatives).

Audits

A cooperative law should naturally make provision for proper auditing. The procedure should be privatized as much as possible, since audits performed by state auditors have generally been less than thorough. The law should therefore stipulate that they be done by qualified auditors who are well acquainted with the special nature and problems of cooperatives. They should not be confined to a simple financial audit but should include a management audit whereby the auditor gauges the extent to which the interests of members have been served by the Management Committee. The law should require the use of bookkeeping and accounting procedures in conformity with national practice and simplified ones for smaller or pre-cooperatives. An annual audit should be compulsory and cooperatives should be deregistered if they fail to have their books audited without sufficient reason.

The establishment of secondary cooperatives performing auditing functions for primary cooperatives should be authorized and indeed encouraged by the law, and official recognition should be granted to auditors graduating from special institutes of cooperative audit. The use of state auditors is only justified when weaker cooperatives are not in a position to pay for private auditors and request the Registrar's assistance. This kind of assistance should be limited to a maximum of three or four years, after which the cooperative should be dissolved if it still cannot pay private auditors or is unable to get assistance elsewhere (from higher-level cooperatives, non-governmental organizations, etc.).

Capital of cooperatives

The cooperative law should be flexible in this regard and not unduly restrict the sources of raising capital. Minimum share capital requirements should not be too stringent since this could prevent persons with little means from participating. In fact the issue of share capital should be entirely left to the by-laws. These should permit the provision of labour or capital goods of any kind to be regarded as a contribution to share capital and should establish an appropriate valuation mechanism for it. The law should provide for alternative forms of member liability and should leave the actual choice to be decided by the members themselves in their by-laws.

The goals which need to be kept in mind when legislating on capital in cooperatives are therefore the following:

- ensuring flexibility in capital raising (while not allowing state participation in share capital) and maintaining the principle of one member, one vote in primary cooperatives irrespective of the capital contribution of members;
- instituting mechanisms to safeguard the interests of creditors and members' deposits;
- securing prior approval of the Supervisory Committee or the General Meeting before making investments or loans above a certain value;
- preserving the right of by-laws to place restrictions on capital raising or capital investments;
- making special provisions for savings and credit cooperatives with regard to minimum liquidity requirements and other financial ratios.

Higher-level cooperatives

Many cooperative laws either do not provide for higher-level cooperatives or the provisions in this regard are extremely restrictive (e.g. making secondary and tertiary cooperatives agents of marketing boards as in Tanzania, or curtailing their freedom of action by preventing the direct export of members' produce as in Uganda until recently). This reflects the inherent fears of politicians about the strong mobilization potential of such higher-level organizations, which are seen as a latent threat to the status quo.

However, the success of any cooperative movement is determined by the strength and efficiency of these higher-level bodies and by the extent to which they can provide effective services to their member cooperatives. It follows that the cooperative law should facilitate the formation of such secondary, tertiary and higher-level cooperatives, guarantee them flexibility in their operations and enable a strong vertically integrated structure to evolve from below in the process. Their economic and promotional functions should be briefly spelled out, leaving the details to be regulated in the by-laws.

Amalgamation, division and conversion

Simple procedures should be foreseen for the amalgamation and division of cooperatives and their conversion to another legal form. However, because of the fundamental importance and possible consequences of such a step, any decision to act in this way should be taken by a *qualified* majority of *all* members of the cooperative (e.g. two-thirds or three-fourths of all members). Furthermore, the law should provide for the voluntary withdrawal of dissenting members as well as for the reimbursement of all dissenting creditors.

Settlement of disputes

Internal disputes should be settled as far as possible within the cooperative (e.g. through the Supervisory Committee or an Arbitration Subcommittee). Where this does not lead to a satisfactory result, the parties in dispute should be able to refer the case to a Cooperative Tribunal specially constituted by the law and comprising experienced members of the cooperative movement as well as legal practitioners. In view of the constitutional right of every person to seek justice in a court of law, this alternative should always be left open to any of the parties in dispute which is not satisfied with the decision of the Tribunal. The advantage of a Cooperative Tribunal lies in allowing faster, more efficient and inexpensive settlement of disputes.

3. Participatory law-making

Cooperative law must be a people's law, which means that it must be written by and for the people. Those who are most closely involved with cooperatives at the grass roots, whether working in the cooperative movement itself or in associated non-governmental organizations, are best placed to know which types of legal provisions are conducive, and which obstructive, to cooperative development. Such persons should be integrated into the law-making process from the very beginning when a cooperative law is being drafted or amended, e.g. through local and regional workshops, by establishing Law Reform Committees on which they are represented or ideally by a mixture of both. If we want to avoid the cooperative law becoming a "phantom law" neither understood nor accepted by the masses, then the participation of such persons is essential. This participatory process should be left to develop its own dynamics and not be cut short by politically imposed deadlines or vested interests. The investment of a couple of years in such a process is well worth while if the result is a lasting law made, understood, identified with and adhered to by the people. There are no short-cuts in law-making, especially in a law aimed at inducing development.

Moreover, it goes without saying that if the law is to be understood by the people, which is a precondition for its acceptance, it needs to be written in simple language, avoiding ponderous legal and technical terms, and translated into local vernaculars if necessary. The experience with participatory law-making in countries like Burkina Faso, Cameroon, Malaysia, the Philippines and Zimbabwe has been positive and bears testimony to the distinct advantages of legislation that results from a process of intensive discussion at all levels.

We have tried to show that a cooperative law can be a useful tool in strengthening cooperatives and thereby indirectly promoting development.

Obviously, however, it is not a panacea for all the ills besetting the cooperative movement: it is only one element in a whole series of variables that need attention if we are to create a favourable climate for the progress of cooperatives.