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## **Market restructuring and Public incentives: the Turkish case of fresh produce marketing cooperatives**

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very preliminary draft

### **Abstract:**

Faced to the fast restructuring agrofood markets in Turkey, the Turkish State set up new institutional devices to support agricultural marketing cooperatives. This article analyses the dynamics of these public incentives towards producers' organizations on the restructuring of the Turkish fresh fruit and vegetable market.

The wholesale market law enacted 1995 established brokers on wholesale market halls who collected an atomized supply and guarantee the access of small producers to large scale markets. However, the attempt to promote cooperatives is less successful. Indeed, lack of funding and skill shortage weaken a great number of them. Therefore, hall brokers enjoy a favorable position as intermediaries in the channel.

In this context, we show how the evolving regulation of public authorities stimulates the dynamics of collective marketing. Because it aims at increasing efficiency, the state supports new forms of market-oriented cooperatives and progressively turns away from its defensive strategy, that is protecting small producers. We investigate the consequences of this evolution and conclude on the ambiguous effects of this intervention.

## Introduction

The rise of supermarkets in developing countries and the subsequent market recomposition has been extensively studied for the last few years<sup>1</sup>. Some studies insist on how crucial may be the State support to avoid small farmers' exclusion from the booming modern market; however there is no further analysis on what should be a state support depending on the local specificities. Most economic researchers focus on cooperative organization issues within given government support.

The Turkish case gives us the opportunity to deepen the analysis of the role of the State in promoting offensive/strategic collective action within small farmers. Turkish State intervention which has long been intensive and pervasive in the agriculture and food sector, keeps being very pro-active and decisive for small farmers and collective action. For instance, wholesale hall regulation has been set up to enhance the small farmers' bargaining power. Likewise, new cooperative statutes have emerged in the last decade, widening the marketing window of cooperatives. Also, credit provision for cooperative investments has been implemented.

Our paper will aim at taking advantage of this quasi-unique situation of a developing country with a small scale agriculture and a State intervention that has been and keeps being very strong. We examine what are the effects of institutional public incentives to support agricultural marketing orientation on the actual cooperatives.

To achieve this study, semi-structured interviews were conducted with a large number of stakeholders in the Fresh Fruit and Vegetables (thereafter FFV) marketing channels: retailers; hall brokers and directors of Wholesale Market Halls; farmers and producers' cooperatives, as well as officers working at governmental institutions at national and local levels. Numerous laws have been also analysed.

The surveys were realized from October to December, 2005. This methodology provides qualitative information, necessary before implementing quantitative tools as a next step of our research project that will integrate the *Regoverning Market Project*.<sup>2</sup>

We first review the Turkish background in order to introduce the mitigated results of the first incentive device from 1995 in favor of Fresh fruit and vegetables marketing cooperatives. We then investigate the institutional change introducing a diversification of cooperatives' legal forms. We finally discuss the impact of these different public incentives on the actual cooperatives.

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1 Global Network on Supermarkets and Agricultural Development and Regoverning Markets Project.

2 For further details about the project <http://www.regoverningmarkets.org>

# 1 Evolution of public incentives in the context of urban food market expansion: supporting small farmers and rural cooperatives

## 1.1 1995: fresh produce market regulation in the context of urban demand expansion

Since the 50's, Turkey experienced a widespread urbanization : about 65% of total population live in cities and several towns like Istanbul, Ankara or Izmir reached a considerable size. In this process, Turkey couldn't escape from the agrofood market transformation pressure. In fact, the number of supermarkets increased rapidly as well as their market share in consumption areas (Reardon and Berdégue, 2002; Weatherspoon and Reardon, 2003). In 1995, they represent around 30% of total food market in Turkey (ME & SIMSEK, 2003). However Fresh Fruit and Vegetables (thereafter FFV), which are at the basis of Turkish food consumption, marketed through supermarket chains remain low regarding to the total FFV marketed volume (Coudel, 2003).

In the FFV sector, it is evidence that large retailers prefer to procure their fresh produce from large-scale producers who have the necessary capacity to offer regularly big volumes of high quality produce (Weatherspoon and Reardon, 2003). However, in Turkey, large producers are not many and are all export-oriented as their comparative advantage on international markets, especially in the Central and Eastern European Countries (Tozanli, 2005). Therefore large retailers are left to procure from numerous small scale producers through intermediaries who manage to build significant volumes from small quantities. This new pattern of urban food supply pushes local agricultural producers towards new challenges in terms of production and marketing. However, small scale farmers are poorly prepared for these changes that bring new opportunities but also could set up high entry barriers to these new marketing channels. In this framework, Turkish state implemented anticipatory policy responses to agrofood restructuring, with special focus on inclusion of small-scale producers in dynamic markets while large producers are restrained in the export sector.

Actually, since 1995 the Turkish state sets up a coercive regulation framework for the FFV domestic market. According to law (law 80 decree 552 from 1995), farmers are obliged to deliver their fresh produce to hall brokers registered and located on the wholesale market hall. The latter endorse the charge of selling it to wholesalers or retailers: thereby, they levy a fee which cannot exceed 8% of the selling price. For each item that they purchase, retailers should be able to show to controlling officers the invoices as a justificatory for these different taxes and fees. In this marketing system, the State and City municipalities deduct taxes and fees that, when added up with hall broker fees represent about 14 % of the total value of the marketed produce.

|                                       |  |
|---------------------------------------|--|
| Hall broker fee                       | 8 % (15 % for income taxes and 0,1 % for retirement funds) |
| Municipality tax                      | 2 % (to pay running costs)                                 |
| Excise tax (stoppage tax on benefits) | 2 %  |
| Social insurance fund                 | 0,1 % (for producer)                                       |
| VAT                                   | 2 %  |
| <b>TOTAL</b>                          | <b>14,1 %</b>  |

The wholesale market law contains however a range of exceptions that reveals a more general strategy concerning market restructuring: articles referring to exporters, industries and cooperatives give us an insight into a more complex framework (Appendix 1).

## 1.2 The place of rural cooperatives in this policy design

According to the wholesale market law, producers' organisations of at least 50 members can get **“Producers’ Union” certificate** (delivered by the Ministry of Industry and Trade) that allowed them, if they sell their products directly to retailers, to not pay the 8% hall brokers' fee and are thus attractive to supermarkets buyers. In this manner, producers' unions act as intermediating agents that can be an alternative to hall brokers.

|                                       |                      |
|---------------------------------------|----------------------|
| Cooperative's fees                    | 3-6 %*               |
| Hall broker's fees                    | -                    |
| Municipality tax                      | (2 %)**              |
| Excise tax (stoppage tax on benefits) | 2 %                  |
| Social insurance fund                 | 0,1 %                |
| VAT                                   | 2 %                  |
| <b>TOTAL</b>                          | <b>7,1 to 12,1 %</b> |

\* *Each cooperative is free to fix this commission fee that helps the cooperative to cover its running costs. Generally, it is fixed between 3 and 6 % of the total value of the marketed produce.*

\*\* *For agricultural cooperatives, there is no legal obligation to pay this tax, but actually they pay it if they rent an office within the Wholesale Market Hall*

At this time, the only *“Agricultural Development Cooperatives”* registered in the Agricultural Ministry and gathering 50 members are able to get the *“Producers’ Union”* certificate (see Appendix 2 and 3).

The *Agricultural Development Cooperatives*, established according to the general cooperative law 1163 (implemented in 1969 according to the international cooperative principles), initially aim "to ensure and maintain economic interests and needs for their members" through "mutual assistance". These cooperatives are defined at the village level (and one village can set up only one *Agricultural Development Cooperative*). They must gather at least 7 farmers-members of the village.

Generally these cooperatives have been established to provide inputs to the members and for various kind of productions. However, because of the new law, they get now incentives to integrate FFV marketing in so far as they gather more than 50 members. Moreover, when these cooperatives were supported in the past by indirect subsidies on the input procurement, this support has been replaced today by low interest rate loans for collective marketing investments.

## 2 Rural cooperatives: a sluggish adaptation to a very dynamic market environment

### 2.1 Fast restructuring of Turkish agro-food market

#### Rapid growth of supermarket

*During the Nineties, the foreign direct investments (FDI) liberalization brought the installation of large international chains (Metro in 1991, Carrefour in 1993), which stimulates, in addition, growth and diffusion of domestic chains. The supermarkets diversified their formats, their geographical establishments and their marketing zones. Today, they aim at all income classes, are spread into medium and small-sized cities and have developed for a few years the format of hard discount.*

*Today, supermarkets account for 45% of total market shares (ME & SIMSEK, 2003),*

Export...

### 2.2 Low results of fiscal incentives directed to cooperatives

In this very dynamic context, the centralisation of a very fragmented supply on the wholesale market hall provides physical access for small producers to large scale markets. Moreover, producers delegate the negotiation of the prices to the hall brokers who enjoy a higher market power (decreasing transaction costs because of scale economy and specialization in marketing activity). This system increases market transparency as prices are known on the wholesale market place. In addition, this type of organization can provide information on existing standards and on the evolution of market requirements to give incentives to upgrade quality and safety and rationalize the production that is oriented to restructured markets.

While the implementation of the law seems to fulfill public authorities' goals in the case of hall brokers, , it's much more difficult for cooperatives.

It's difficult to assess the exact number of *Agricultural Development Cooperatives* committed in FFV marketing orientation, because they often gather various production activities. However, we estimate that 85 cooperatives have a significant FFV production activity; at least 24 received loans for greenhouses building; around 5 cooperatives received loan for cold-storage and packaging facilities investments and get also the Producer Union certificate from the MIT (Lemeilleur and Tozanli, 2006).

In fact, in spite of this new fiscal incentive, cooperatives meet considerable constraints stemming from the difficulties of small producers to organize themselves around Producers' unions.

Firstly, the strong subsidies restriction for agricultural cooperatives during the 80s has induced a progressive abandonment/ disinterest of these collective structures by farmers. Moreover, large problems of free-riding and corruption in cooperative organizations have led to distrust among farmers for this kind of structures.

In this context, reorienting the cooperative structure toward marketing orientation shows large functioning difficulties. Therefore, in 1995, very few cooperatives are able to get the advantage from the wholesale market law.

From the producer side, lack of skill and funding in cooperative to implement marketing organization gives less attractiveness to market their produce by cooperatives rather than hall brokers (specialized in this activity). The latter, through kind of exclusive interlinked contract providing advance payment to farmers in exchange of output, restrain also emergence of collective action for marketing (Lemeilleur, 2005).

Finally, to gather 50 producers at the village level seems to be also a big constraint to found Producers Union.

According to the cooperative literature, cooperatives emerge for different reasons: overcoming market failures (access constraints and uncertain outlets), enhancing economies of scale, reinforcing bargaining power, sharing risks, reducing transaction costs and promoting innovation (Bijman and Ruber, 2005). A more sociological (and institutional economics) approach understands also the development of cooperatives as a response to enduring, unequal power relationships and inequalities in assets or resources in the agricultural marketplace (Mooney and Grey, ...).

In the Turkish case, with hall brokers activities, an important part of the market failures and transaction costs issues between small producers and others stakeholders of the channel, has been solve. Thus, in spite of fiscal incentives, and according to the literature, it is more easy to understand that maybe farmers cooperation does not represent a major stake for Turkish FFV producers.

The cases were we can observe *Agricultural Development Cooperatives* that emerge as a strategic form of marketing are located in regions where FFV represent the main part of the production, but regions which include only a few number of wholesale market halls. Therefore, cooperatives endorse the charge of collecting products and selling them to wholesalers. The latter are often hall brokers, cooperatives are rarely present on the wholesale market hall. Thus, we can wonder if cooperatives intervene as a defensive strategy to overcome market failures (namely market access constraints), when hall brokers are absent in the production area.

### **3 Enlarging the legal framework: between coherence and contradiction?**

State regulation of the cooperative sector evolved considerably since 1998: the increase in the number of statutes legally offered gave place to new marketing opportunities for small farmers.

#### **3.1 Promoting incentives for collective action: the diversification of rural cooperation statutory forms**

In 1998, the Ministry of Industry and Trade launched the "*FFV marketing cooperatives*": they are based on the statute of traditional cooperative established in 1969, the so-called *Development Cooperatives*. This literal designation puts forward their aim at marketing

produce in the Fresh Fruit and Vegetable sector. They are eligible for state support and credit under restricted conditions.

They are entitled to afford a “Producers’ Union” certificate by the Ministry of Agriculture and Rural Affairs if they are composed of more than 50 members. In this case, they can bypass the hall broker to sell directly to retailers.

“*FFV Marketing Cooperatives*” tend to develop (in a same village) as an alternative to *Development cooperatives*, when the latter are not involved in FFV production or when they face functioning problems (free-riding, corruption...). However, only 34 *Marketing cooperatives* were registered by the Ministry of Industry and Trade in 2005, and less than half of them obtained a “Producers’ Union” certificate. In fact, they should be composed of more than 50 members to be entitled to get a certificate: but as they emerge at the village level, their chance to gather such a high number of producers who should share equivalent goals is rather low. Furthermore, these cooperatives face a wide range of difficulties in marketing their products because lack of skill and funding problems. Therefore, they often reach the only activity of collecting products.

Moreover, the Ministry of Agriculture and Rural Activities modified in May 2005 the role of the long-living “*Agricultural Credit Cooperatives*” that emerge in the 1930’s. Those had been established and administered by national authorities and provided under its supervision farmers with subsidized inputs and seasonal credit. They evolved since the late 1990’s towards an independent statute and autonomous management. Their administrative basis lies between the district and the province level, due to central authorities decision, and they should be composed at least from 30 members. They are only rarely specialized in a precise type of products.

As the cooperatives’ forms presented above, they are since 2005 allowed to register as “Producers’ Unions” by the Ministry of Agriculture and Rural Activities if they are composed of more than 50 members.

Finally, since they are allowed to integrate marketing activities, these cooperatives seem to be the most promising structure to market products, because they dispose over a high level of human and financial capital. In fact, administrated for a long time by the State, “*Agricultural Credit Cooperatives*” bypass a number of organizational problems because of the inclusion of an agricultural engineer in the structure of each cooperative. They bypass equally problems related to advance payments because of their capacity to obtain cash credits from banks. Nowadays, 1964 “*Agricultural Credit Cooperatives*” are active on the whole Turkish territory. These are large structures composed generally of about 1000 members. Since the law that allows them *to market* products was passed in 2005, almost 300 credit cooperatives are already certified as “Producers’ Union” and can thereby market their products outside wholesale markets, even if only few of them actually started to do so (these latter contract with supermarkets and hypermarkets).

Further opportunities arise with the legislation on “*Agricultural Producers’ Unions*” defined by the Ministry of Agriculture and Rural Affairs (law 5200, January 2005). Such unions were designed to promote production planning, quality standards implementation and marketing of products on the domestic market as well as for exports. They are devoted to one product, or type of product and are not explicitly eligible for state support and subsidies. Their administrative basis is the sub-province and only one “*Agricultural Producers’ Union*” can be

registered for one product in a sub-province. A minimum size is also set by the law: an "Agricultural Producers' Union" should count at least 16 members - juridical, artificial or physical persons – that account for 10% of the production area of the considered product in the sub-province, or more than 10%.

"Agricultural Producers' Unions" were not designed to market products, they were still meant as unions specialized in a field that could sustain production planning and processes among their members. However, even if it positively assigns precise activities to cooperatives, the law on "Agricultural Producers' Unions" doesn't prevent collective organisations registered as such to adopt a wider range of activities including marketing (which didn't belong to the spirit of the law). A new decree from the Ministry of Industry and Trade would take note of this deficiency by allowing "Agricultural Producers' Unions" to get Producers Union certificate to sell products, in so far as they gather at least 50 members (by this way, it reveals the lack of coordination between both ministries).

"Agricultural Producers' Unions" are often created by large producers: as these cooperatives operate at the regional level, a coordination between their members is more difficult to achieve. Although they were initially not designed as marketing cooperatives, large producers who were originally rather export-oriented, find the opportunity to turn their production to the domestic market. They expect through these structures to bypass the hall broker so that the incentive to market their product on the domestic market increases. They overcome also scale problem of village level cooperatives that face difficulties to gather 50 members and collect enough products.

As a consequence, around 100 "Agricultural Producers' Unions" have been registered since January 2005, among them 50% are dealing with FFV. The major constraint expressed by the producers trying to create an "Agricultural Producers' Union" is linked with the minimal coverage of the members' land relatively to the total size of the sub-province. None of them applied to afford a "Producers' Union" certificate yet, mainly because they are beginning by laying the basis of their development. .

### **3.2 First promising results raise some concern about previous policy objectives**

The only institutional change of 1995 did not allow producers' organisations to benefit from the wholesale market law opportunity. It is with the actual conversion of Credit Cooperatives and implementation of new Agricultural Producers' Union that appears real potential of collective action for marketing. However these collective forms integrate this activity not in a defensive strategy, namely in order to overcome market failure (that's Cook named Nourse's form (1995)), but rather through an offensive strategy in a dynamics of innovation to operate directly with retailers (as Shapiro's form (Cook 1995)).

Their advantage to overcome common cooperative constraints comes from a higher potential in terms of human capital and financial capital. However, these initiatives are not yet stabilized and very few are really committed in the collective marketing of the FFV.

The embedding of successive legislative measures seems to be an appropriate public strategy for the emergence of marketing collective forms according to the context and the stakeholders involved. However, these collective forms, because of their intern rules or because of the stakeholders involved, tend to turn away from the fundamental cooperative principles (open membership, democratic and equitable member control, concern for community...) and appear to function rather like Clubs (Olson, 1966) with screening rules. Thus, they do not lead to the same results in terms of inclusion of the small producers in the restructuring market,

since the latter are not able to fulfill entrance conditions imposed by the Club (volume, quality and maybe product certification...).

## Conclusion

The fast restructuring of agrofood markets which occurs in middle and low-income countries is often characterized by progressive exclusion of small farmers poorly prepared for the changing way of agrofood market governance.

The Turkish state appeared to be very proactive to these small farmers to avoid their exclusion which could represent a significant social cost in this country where the major suppliers in domestic market happen to be a great number of small-scale producers and where unemployment reaches 10% of the population.

Therefore, in order to include farmers into these restructured agrofood markets, the State sets up new institutional devices through the wholesale market law in 1995. In this paper we focused on the both major points of this law:

1. establishment of hall brokers recognized and appointed by the government, who endorse the charge of gathering and selling all the FFV production to wholesalers or retailers, in return of 8% fee.
2. fees exemption for producers' unions of at least 50 producers which sell products directly to retailers. By this way, the cooperatives which remained latent after the subsidies reduction, should take a new dominant position in the market restructuring.

Actually, as a first result, this law intensifies the competition between these two forms of intermediation. Now, in spite of the fiscal advantages granted to cooperative, this is the hall brokers' system which has quickly dominated all the intermediation, mainly because it gathers much more capabilities for marketing products.

In this context, hall brokers could appear efficient to fulfill the requirement of farmers' inclusion in the market. That's why we can question what led public authorities to maintain the support to cooperatives in this way.

Two hypothesis could explain the government strategy to maintain cooperative support:

1. to allow producers to get a greater part of added value on the new markets thanks to localized collective investments, in a framework where the hall brokers ,that is the only actual intermediaries between supply and demand, tend to bring to standstill domestic market development. Indeed, in Turkey, standards are still absent, except some commercial standards upon size and appearance that have been developed and implemented by few private large-scale retailers (Codron et al., 2004).
2. to provide through cooperatives a range of social, political and cultural capital for farmers and their communities (Torgerson, 1999) as "positive social externality" from a collective activity that other forms can't generate. Torgerson posits that such values and interests are have the characteristics of "public goods" and so, fiscal policies which are justified today insofar as it rebalances market failures or externalities, could appear relevant.

However the results of the enlarged legal framework for collective forms are ambiguous , so that they question the government's strategy. Indeed, since the target of these incentives was gradually directed towards "a strategy of clubs"(Olson, 1966), that leads to exclude small producers, and so to give up any social externality.

This work assesses the impact of Turkish public intervention on cooperative strategies and, how this intervention supports the inclusion of small farmers into the supply chains of an ever growing modern food market. Characterized by a long history of State intervention, the Turkish case brings understanding on the role of public authorities in market regulation, and its impact and limits on producers' organizations and urban food security.

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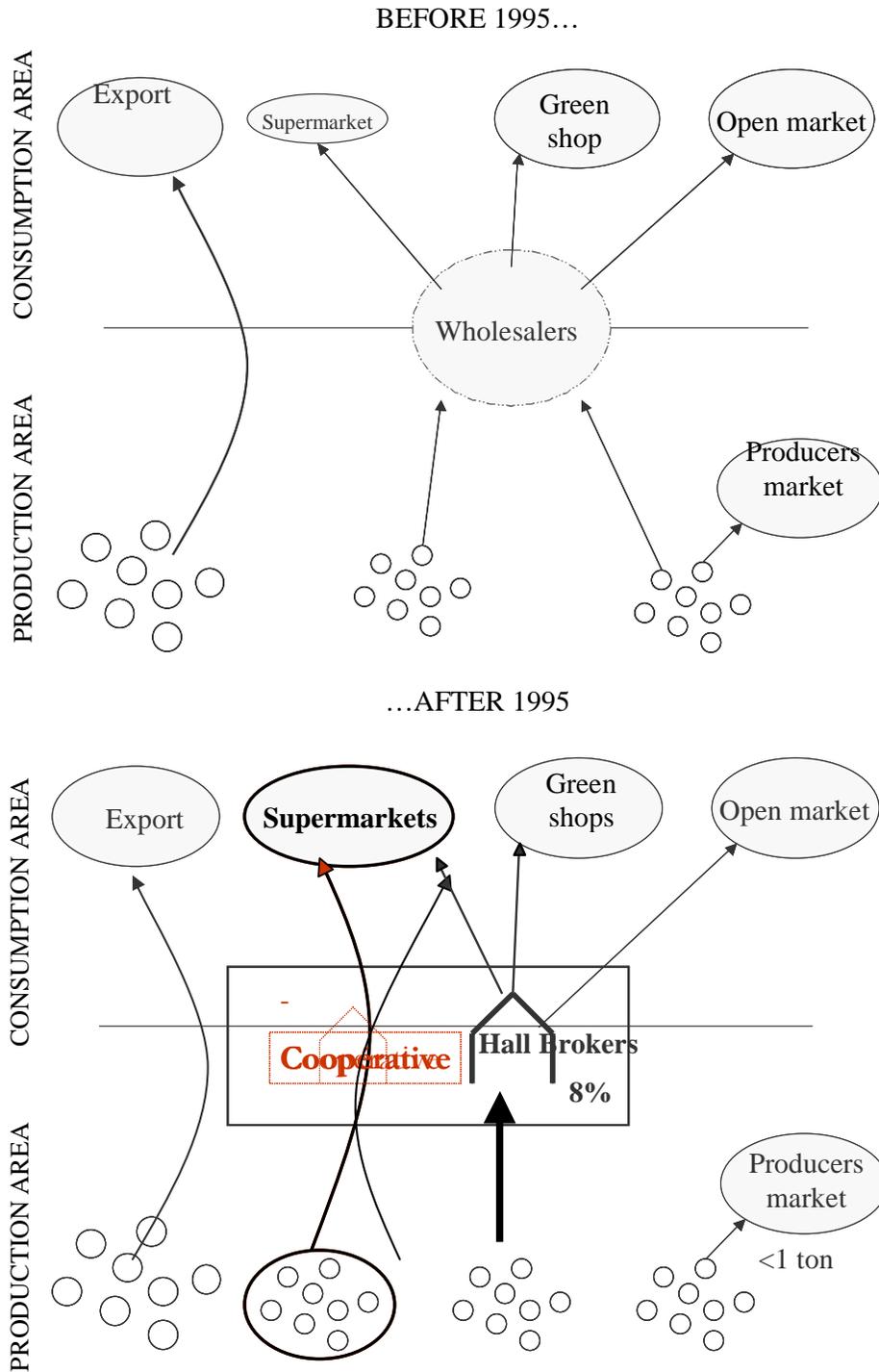
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## APPENDIX

Appendix 1: Fresh fruit and vegetables marketing channel in Turkey, before and after the wholesale market law of 1995.



**Appendix 2 : Laws, objectives and activities according to cooperative types.**

| MINISTRY                         | MINISTRY OF AGRICULTURE AND RURAL AFFAIRS   |   |  | MINISTRY OF INDUSTRY AND TRADE   |
|----------------------------------|---|---|--|--|
| Type of producers' organizations | <i>Agricultural Credit Cooperative<br/>(Tarim kredi Kooperaifi)</i>   | <i>Agricultural Development Cooperative<br/>(Tarim kalkinma Kooperatifi)</i>  | <i>Agricultural Producers Union<br/>(Tarim üretici biligi)</i>   | <i>Fresh fruit and vegetable marketing Cooperative<br/>(Yas sebze ve meyve pazarlama kooperatifi)</i>  |
| Law/ Date                        | <i>Law 1581 ⇒ law 5530 (May 2005)</i>   | <i>Law 1163 (May 1969)</i>  | <i>Law 5200 (January 2005)</i>   | <i>Law 1163 (May 1969)</i>   |
| Objective & activity             | <i>-Sells low price inputs and equipment<br/>-Manages government loans for members<br/>-Greenhouse insurance<br/>-Since 2005:sells fresh fruit and vegetables</i> | <i>-Insures and maintains economic interests and needs for members, by mutual assistance of services and solidarity<br/>-Buys collectively inputs<br/>-(sells agricultural production collected from members)</i> | <i>-establishes production planning<br/>-improves quality and standards for domestic and international market<br/>-(unofficially) sells fresh fruit and vegetables</i> | <i>-insures and maintains economic interests and needs for members, by mutual assistance of services and solidarity<br/>-sells FFV production collected from members</i> |
| Specificity                      | <i>-Members are not all FFV producers<br/>-sale of all kind of FFV<br/>- still strongly linked to the state</i>   | <i>-Can get government credit for large collective investment but no more subsidies<br/>-sale of all kind of FFV</i>  | <i>-(Nowadays) no financial support from the government<br/>-1 kind of FFV per union</i>   | <i>- (officially) Can get government credit for large collective investment (but no observation)<br/>-sale of all kind of FFV</i>  |

**Producers Union Certificate (*Uretici Biligi*) from the MINISTRY OF INDUSTRY AND TRADE**

- *Law 80 decree 552(1995) ⇒ new law forthcoming 2006 ?*
- *Objective: Protects small producers by hall brokers and support producers' organization by exemption of hall broker fees.*
- *But no financial support*
- *Can sell all kind of FFV*

### Appendix 3 Internal rules according to cooperative types and administrative level

| MINISTRY                         | MINISTRY OF AGRICULTURE AND RURAL AFFAIRS                             |   |  | MINISTRY OF INDUSTRY AND TRADE   |
|----------------------------------|---|---|--|--|
| Type of producers' organizations | Agricultural Credit Cooperative<br>( <i>Tarim kredi Kooperatifi</i> ) | Agricultural Development Cooperative<br>( <i>Tarim kalkinma Kooperatifi</i> ) | Agricultural Producers Union<br>( <i>Tarim üretici biligi</i> )  | Fresh fruit and vegetable marketing Cooperative<br>( <i>Yas sebze ve meyve pazarlama kooperatifi</i> ) |
| Village                          |   | 1 unit cooperative per village<br>>7 members                                  |  | 1 unit cooperative per village<br>>7 members   |
| District<br>(Kasaba)             | Unit Cooperative<br>>30 members                                       |   | 1 unit APU per product per sub-province<br>>16 members ( <b>physical, artificial or juridical person</b> )<br>>10% of cultivated land for this product |  |
| Sub-province                     |   |   |  |  |
| Province                         |   | Cooperatives Union<br>>7 cooperatives   |  | Cooperatives' Union<br>>7 cooperatives   |
| (region)                         | Cooperatives' Union<br>>30 cooperatives                               |   |  |  |
| National                         | 1 National Union  | 1 National Union<br>>7 Cooperatives' Union                                    | 1 national Union per product   | 1 National Union<br>>7 cooperatives' Unions  |
|                                  | Agricultural Cooperative Federation                                   |   |  |  |

Registered by MIT to get the producer union certificate

- Producers Union Certificate  
>at least 50 members
- Can get an office in the wholesale market