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INCLUSION OF SMALL
FARMERS INTO
PRODUCTION VALUE
CHAINS THROUGH
STRENGTHENING
AGRICULTURAL
COOPERATIVES IN
KAZAKHSTAN

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KEY POINTS

- Although the investment in fixed capital in agriculture has increased four times in the last ten years, Kazakhstan's agricultural sector has decreased significantly and the country has become a net importer of agricultural products since 2009.
- Strengthening small-scale farmers is essential: 76 per cent of the agricultural output is produced by small farmers in Kazakhstan, 22 per cent of the labor force is in the agricultural sector and 43 per cent of the Kazakhstani population is based in rural areas.
- Crop production has high export potential in Kazakhstan, but it remains highly dependent on weather conditions and the size of the cultivated area. The instability in output has a strong negative impact on the financial conditions of the Kazakhstani agricultural companies and especially on small-scale farmers.
- In the agricultural sector, large-scale producers have easier access to technologies, state subsidies, and equipment for saving grain as well as to international networks to export their commodities. This creates dependence of small-scale producers on large scale producers when distributing and exporting products.
- In October 2015, the Kazakhstani government accepted a unified law on agricultural cooperatives. Due to high level of corruption and weak rule of law in Kazakhstani institutions, there is a risk that the adopted laws will not be implemented effectively. It is important to facilitate the implementation process across the country in order to familiarize the main stakeholders about the changes and opportunities.



WHY IS IT IMPORTANT?

The export potential of Kazakhstan in agriculture has obvious comparative advantages due to the presence of huge natural resources and geographical location. Kazakhstan has 180 million hectares of pasture and is bordered by two countries of the world's ten largest economies: Russia and China. Essential share of the country's budget income from oil exports has been allocated to the agricultural sector within the state programme called "Agrobusiness-2020". The investment in fixed capital in agriculture has increased four times in the last ten years. However, great financial inputs have not resulted in greater achievements: agricultural imports have outpaced exports, leading Kazakhstan to become a net importer of agricultural products since 2009. The share of agricultural output in the GDP since 2000 has decreased by 37 per cent (graph 1).¹ Adding to a pressure of dropping oil prices and devaluation of the tenge, at the current stage, reducing the country's reliance on food imports and ensuring food security are strategic policy objectives for the government of Kazakhstan.

But who are the main stakeholders in the agricultural sector? 76 per cent of agricultural output is produced by small farmers in Kazakhstan. Moreover, farmers are considered to be an essential part of the society: 22 per cent of the labor force is employed in the agricultural sector and 43 per cent of the Kazakhstani population is based in rural areas. However, this fact does not stop large agricultural companies from playing a dominant role in the market, yet. Small farmers in Kazakhstan face obstacles of ineffective market mechanisms and state regulation. The large-scale producers own more favorable conditions compared to small-scale farm-

1 The share of the agricultural sector in the GDP comprised 7.4 per cent in 2000 and 4.6 per cent in January-September of 2015. Committee on Statistics, Ministry of National Economy of Kazakhstan, <http://stat.gov.kz/faces/wcnav_externalId/publicationsSocial2006?_afLoop=26935523955552688#%40%3F_afLoop%3D26935523955552688%26_adf.ctrl-state%3Dibrev5xc0_76> (accessed 15 September, 2016).

ers. After massive criticism by experts and farmers as well as recommendations from the OECD, the government accepted a law on cooperatives transforming them into commercial organizations which are able to choose a suitable tax regime and may distribute income among its members. Kazakhstan's government is slowly paving its way towards building a market economy. There is a lot to do to create effective market mechanisms in the sector though.

According to the OECD, in 1991 small-scale producers accounted for 32 per cent of agricultural output, whereas by 2013 their share had increased to 76 per cent. Besides, households and individual farms contributed 66 per cent to crop production and 89 per cent of livestock production. Small producers also play an important role in the output of other products, such as grain (37 per cent in 2012), rice (39 per cent) and eggs (36 per cent). But unfairly, small farmers in Kazakhstan face difficulties such as constraints in obtaining bank loans, high transportation costs, difficulties in investing in new technologies as well as lack of finance for purchasing farm machinery and transportation equipment. Also, small farmers and households have low bargaining power with large processors and input suppliers. Furthermore, most of the small farmers do not use or have no access to business advisory services. These factors prevent small scale producers from integrating into greater production value chains.²



THE STORY OF AGRICULTURAL REFORMS IN KAZAKHSTAN

After the collapse of the Soviet Union, Kazakhstan aimed to turn into a market oriented economy. During the early years of independence (1992-1997) it was a priority for Kazakhstan's government to conduct land reforms, privatize collective farms and pro-

2 Presentation of the OECD EURASIA Competitiveness Programme on strengthening agricultural co-operatives in Kazakhstan p.18, <<http://www.oecd.org/globalrelations/eurasia.htm>> (accessed 26 September 2016).

vide food security in the country through regulating prices and subsidizing producers. These priorities dominated over other not less important areas of agricultural policy which were neglected. During the period of 1998-2002 Kazakhstan's economy has been recovering from economic crisis. As a reaction, the government has initiated programmes of preferential machinery leasing and agricultural credits. However, rural areas still had social and economic challenges due to depreciated capital stock. Starting from 2003 higher income from oil boom increased public support in the agricultural sector. The goal was to accelerate economic diversification, increase competitiveness of the sector through fuel subsidization, machinery leasing, preferential credits and tax concessions. Protectionist approach has been strengthened, especially in meat production.³ Later, Kazakhstan started the integration process to become a member of the Customs Union and the Eurasian Economic Union. In 2015, Kazakhstan became a member of the WTO. The integration process shocked the local and more vulnerable agricultural companies compared to the more developed foreign enterprises. The integration was for the benefit of the consumer in Kazakhstan, but not for the mostly subsidized and fragile agricultural companies in the country which had high production costs. Acceptance of the unified legislation on agricultural cooperatives in 2015 was a significant step towards developing market mechanisms. Implementation is another issue: according to experts and international organizations, there is a high rate of corruption, lack of transparency and bureaucracy which makes the implementation of such legislations complicated and even in some cases impossible in certain regions.



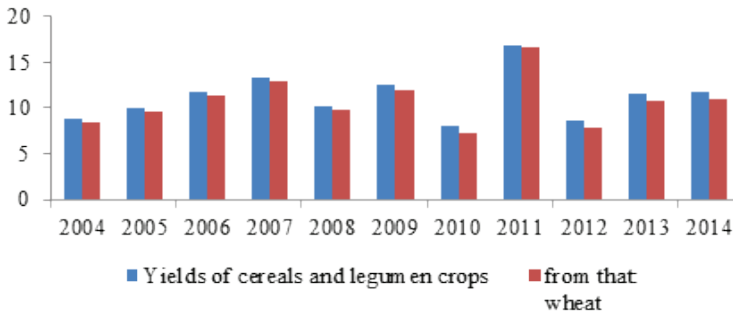
THE STATUS QUO

The production of crops in Kazakhstan is volatile from year to year, because normally its increase is not achieved by productivity

3 OECD (2013), OECD Review of Agricultural Policies: Kazakhstan 2013, OECD Publishing pp. 22-23, <<http://dx.doi.org/10.1787/9789264191761-en>> (accessed 1 October 2015).

growth, but by increasing the cultivated area and due to favorable weather conditions. The gross grain harvest in Kazakhstan ranged from record harvests in 2007, 2009 and 2011 to very low volumes in 2010 and 2012 (graphs 2 and 3).⁴ The instability in output has a strong negative impact on the financial situation of the domestic grain producers, especially small farmers. Manufacturers lose most of their income, which leads to an increase in debt to creditors, not to mention their ability to attract additional funding. According to the National Bank of Kazakhstan, arrears on loans to banks in the agricultural sector at the end of 2013 amounted to 35.1 billion tenge (227 million USD) and during the first seven months of 2014 it doubled, reaching 68 billion tenge (370.5 million USD) which is partly explained by the devaluation of the local currency.

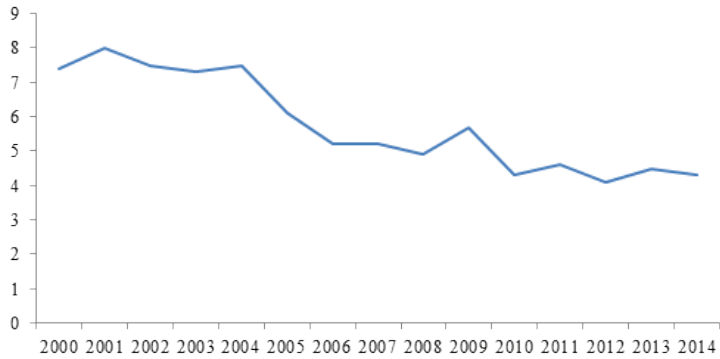
Graph 2. Yields of cereals and legumes in Kazakhstan, 2004-2014, in quintals per hectare



Source: Statistics Committee of Kazakhstan, Ministry of National Economy of Kazakhstan

⁴ Committee on Statistics, Ministry of National Economy of Kazakhstan, <http://www.stat.gov.kz/faces/wcnav_externalId/homeNumbersAgriculture?_afzLoop=26991385665951298#%40%3F_afzLoop%3D26991385665951298%26_adf.ctrl-state%3Dqrrguylc_v_50> (accessed 1 October 2015).

Graph 1. Share of agricultural sector in the GDP of Kazakhstan has been decreasing during 2000-2014



Source: Statistics Committee of Kazakhstan, Ministry of National Economy of Kazakhstan

One of the reasons of low productivity in the Kazakhstani agricultural sector is the deterioration of technology (80 per cent). The share of tractors and combine harvesters used for more than ten years in the total amount comprises 94 per cent and 77.7 per cent, respectively. Moreover, over the past ten years the number of technology units has increased only slightly, during the last twenty years it has even declined. The share of population in rural areas is decreasing thereby demonstrating that the demand for technological renovation will be crucial for food safety in the country.

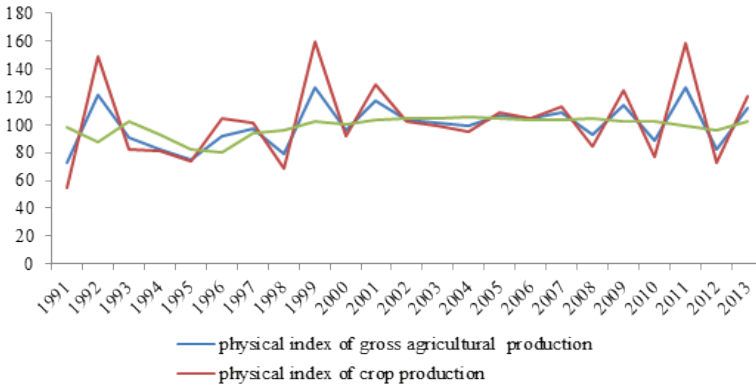
The dominating part of subsidies is transferred to producers and for extracting resources rather than for manufacturing. The above mentioned challenges exist due to the ineffective market regulation and irrelevant public investment in the agricultural sector.

Table 1. Agricultural sector in the economy of Kazakhstan

	1990	1995	2011	2012	2013	2014
Share of agricultural sector in GDP (per cent)	34	12	5	4,1	4,5	4,3
Share of agricultural sector in total volume of exports (per cent)	-	13	2.2	3.4	2,8	3,2
Share of agricultural sector in total volume of imports (per cent)		11	10.7	8.3	8,9	9,6
Agricultural trade balance (million USD)	-	251	-546	380	-453	-225
Agricultural land (million hectares)	221	214	222	-	96,2	98,5

Source: Statistics Committee of Kazakhstan, Ministry of National Economy

Graph 3. Physical index of crop production is significantly volatile



Source: Statistics Committee of Kazakhstan, Ministry of National Economy of Kazakhstan



INTERNATIONAL EXPERIENCE AND LESSONS TO LEARN

International experience demonstrates that the integration of small farmers into value chains through developing cooperatives is the optimal option for developing the agrarian sector. In developed countries, forming cooperatives have transformed farmers into entrepreneurs, which contributed to the modernization of the agricultural sector and reduced poverty in many countries. Currently, the average proportion of cooperatives in the market is 60 per cent in Europe and 80 per cent in the USA. Also, according to the International Cooperative Alliance (ICA), 110 out of the world's 300 largest cooperatives were created in the agricultural sector.

Cooperatives enable farmers to reduce costs through conducting joint procurement of raw materials, supplies or equipment, economies of scale at the stages of processing, marketing and distribution, as well as to achieve better prices in the negotiations. Moreover, they reduce market risks operating costs, provide wider access to financial and human resources, and enhance the competitiveness of members. They contribute to the emergence of new products in the market and provide for better quality and safer food. The integration of small-scale producers not only strengthens the positions of farmers in the market, but also, most importantly, gives them the opportunity to participate in and influence on the development of agricultural policy.

New Zealand, and Italy (more precisely, the Italian province of Trentino) serve as the most vivid examples of successful cooperative development. The main organizational form of companies in the dairy industry of New Zealand has been cooperatives. The main goal in creating cooperatives was the desire to improve production efficiency, strengthening market positions, gaining access to new technologies and expanding access to finance. For example, Fonterra multinational dairy cooperative with more than 16,000

members gathers 22 billion liters of milk and provides about 17 per cent of world exports of dairy products. Fonterra was formed in 2001 through the merger of the two largest cooperatives of New Zealand. This cooperative is considered as one of the most successful cooperatives in the world.

The first retail trade cooperative in Trentino (Italy) was created in 1890, which was followed by the opening of a cooperative bank. Opening of retail trade cooperatives and the cooperative bank led to the emergence of a Federation of Cooperatives. Today, the Federation includes 545 enterprises operating in the four main sectors (loans, retail, agriculture, and others). Trentino became one of the richest provinces of Italy: the region's GDP is 30 per cent above the European (EU) average. Cooperatives combined 90 per cent of farmers and play a key role in the export activity.

Australia. The Australian society Devondale Murray Goulburn, was founded in 1950 on the basis of 14 dairy farms, and eventually turned into the country's largest processor and exporter of dairy products. In 2014 it included 2,580 members, the amount of produced dairy products was 784,000 tons, and revenues reached 2.9 billion Australian dollars.

It is fair to admit that the Kazakhstani government has taken the first step towards creating a platform for developing agricultural cooperatives in the country. In October 2015, the government developed a Unified Law on agricultural cooperatives which is supposed to ease the tax and regulatory framework for agricultural cooperatives in Kazakhstan. Before, the service cooperatives were (and are until 2016) considered as non-profit organizations, the profit of which may not be distributed among its members. This weakened the sense of responsibility of farmers, members in agricultural cooperatives. Cooperatives faced difficulties in raising money from their members and often worked inefficiently. Being considered as a non-commercial entity, forming cooperatives significantly increased the tax burden for the cooperative members (compared to individual farms which have special tax regimes and households that pay only personal income taxes). As a result,

farmers and households had no incentive to create new cooperatives or to get access to existing ones. Households have the least incentive to enter into cooperatives, as in the case of accession, they will have to pay income tax.⁵ Small farmers tend to create informal cooperatives or to continue to work independently in the local market with low productivity and small scale activities.

RECOMMENDATIONS

It would be preferable to pay more attention to the development of service cooperatives rather than to existing production cooperatives, which hold the 'reputation' of ineffectiveness since Soviet times. Service cooperatives may provide services to members (negotiations with credit institutions, the purchase of raw materials or product sales), without encroaching on the independence of farmers.

In these regards, the following recommendations are put forward:

1. Developing an institution for strengthening cooperatives in Kazakhstan. In November 2013, the government of Georgia launched the Agricultural Cooperatives Development Agency under the Ministry of Agriculture. The agency was created as an independent regulatory authority to support the commercialization of agricultural small farms and households to create better access to market services, infrastructure and credit. The main duties of the agency include the implementation of public policies for the development and the registration of agricultural cooperatives, providing trainings, providing business consultancies to cooperatives, monitoring and evaluation, as well as organizing conferences, meetings and seminars on relevant issues and problems. In addition, the agency is involved in the implementation of providing information and educational programmes to raise awareness about the possibilities

5 Private sector development: Policy Handbook. Strengthening agricultural co-operatives in Kazakhstan, p. 42, <<http://www.oecd.org/globalrelations/eurasia.htm>> (accessed 2 November 2015)

of cooperatives in rural areas. Registered cooperatives are eligible for state support, with a condition of regular reporting. This strengthens the Agency's ability to closely monitor the development of agricultural cooperatives.

2. Capacity building and information campaigns. Development of agricultural cooperatives may be achieved through information campaigns in rural areas, which would help to explain the essence of service cooperatives and the advantages of joining their ranks. The training programme should include practical advices on the organization of cooperatives, registration of legal documents, preparation of feasibility studies, preparation of the charter and the foundation agreement of the cooperative, and so on. One of the successful examples of providing information services and technical assistance to cooperatives is the Centers for the Development of Agricultural Cooperatives in the United States.

These Centers, funded by cooperatives and the US Department of Agriculture represent a good example of cooperation between the public and the private sector in providing information services, training and technical assistance to members and managers of cooperatives. The main functions of the centers is an explanation of the nature and benefits of forming cooperatives, conducting trainings on operational management, as well as providing information on the regulatory issues for the establishment of new cooperatives. Additionally, existing and future cooperatives are offered grants for technical assistance in carrying out feasibility studies, evaluation of management structure, improving the organizational structure, organization of surveys among member farmers that belong to the centers, evaluation of potential opportunities in merging or the formation of a joint venture, as well as in the development of strategic marketing or business plans.

3. Targeted financial support. Financial support to cooperatives in Kazakhstan is limited and is carried out mainly by the state. Inability of small farmers to obtain financing from commercial

banks is often a consequence of strict requirements, lack of assets and reserves and the lack of alternative credit mechanisms, such as group lending and loans secured by future supplies. Current measures to support financial cooperatives are characterized by inefficiency and poor target group orientation. Moreover, cooperatives cannot participate in government procurement of grain, conducted by the Food Contract Corporation. At the same time, the Fund for financial support of agriculture has no microcredit programmes, and cooperatives have no possibility to lease machinery and equipment through “KazAgroFinance.” The Government should introduce a range of tools targeted on financing cooperatives, including seed capital, grants and concessional lending. Funding should be oriented on operating cooperatives in order to avoid the allocation of funds for not active cooperatives. In addition, the government should implement a monitoring system to ensure the effective use of funds to support the activities and development of cooperatives.

4. Private sector participation in the financing of cooperatives. In addition to the development of state financial support, involvement of the private sector in financing cooperatives should be intensified. Besides many other advantages, financial support of the private sector gives small farmers more incentives to form cooperatives as well as providing stability. Especially, producers of food and drinks have significant stimulus to promote the growth of the productivity in small farms and to use cooperatives as a means of continuous supply of raw materials for processing. Thus, the government should introduce mechanisms to encourage more active participation of large processing enterprises and operators of wholesale and retail trade in supporting the development and expansion of the cooperative. For example, the Chinese government has offered to a number of leading companies to collaborate with farmers and help them to achieve certain quality standards. As a reward for his contribution in strengthening the vertical integration in the agricultural sector, as well as the development of standardization and certification, such companies have been granted public subsidies.
5. Establish a pilot cluster in a Kazakhstani region with strong ag-

riculture potential in order to form trade and logistics infrastructure there. This cluster can be linked to the existing free economic zone and enhanced by the creation of a logistics centre. It will be necessary to identify potential participants and offer them possible incentives (such as tax holidays, simplified procedure for exporting goods, special credit lines) and conduct closer monitoring over the process. Joining the cluster may be on a voluntary basis. In addition, it is essential to provide a free choice of joint activities within the cluster. The cluster will contribute to sharing the cost of technology, promotion, transport and quality control. It is also necessary to attract the participation of commercial banks, government agencies and academic institutions within the cluster.



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