

Recent Experience with Agricultural Co-operatives in Israel*

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Although agricultural output in Israel has grown steadily over the last fifty years and per-capita production kept increasing, the sector contributes today less than three percent of GNP. Compared with other parts of the economy of Israel, agriculture is small. Partly, at least, this tiny share is due to relatively low prices. Producer prices have been gradually falling, particularly since the early 1980s, in line with expanded supply and with trends in world markets. These industry-wide changes have affected the fate of the farm sector and of co-operative agriculture.

Israel has been, since its establishment in 1948 and even before that, a testing ground for institutional settings in agriculture. Approximately eighty percent of agricultural output in Israel is produced on co-operative and communal farms; the rest is produced by privately owned enterprises. Time and shifting circumstances have forced significant structural changes on co-operative agriculture. In preparation for the discussion of these changes, the survey is opened in the next section with a basic, telegraphic description of the co-operatives. To simplify the exposition, the description is written in the present tense although, as will become clear below, some of the early institutional characteristics have disappeared and others are being modified with ongoing reforms.

* The preparation of this paper was supported by NIRP, Netherlands-Israel Development Research Programme in the project THE TRANSFORMATION OF FARMER COOPERATIVES IN TANZANIA: A STUDY OF THE ORGANIZATION AND MANAGEMENT PROBLEMS OF EMERGING COOPERATIVES IN SELECTED REGIONS (95-12.1).

Co-operatives

There are four major forms of agricultural co-operatives in Israel: kibbutzim, moshavim, communal moshavim, and secondary service co-operatives. Many other small co-operatives also exist, but they will not be surveyed in this report.

A kibbutz (pl. kibbutzim) is a village of 200-2000 people. Today there are 269 kibbutzim in Israel. Basically the kibbutz is a commune in which members work on the collective farm and in the non-farm enterprises—manufacturing and services. Consumption (food, lodging, clothing, education, health care, etc.) is provided on egalitarian principles and “according to needs”. Strictly speaking and by conventional definitions, the kibbutzim are not co-operatives, but they are an integral part of the institutional setting of agriculture in Israel and their story complements the examination of the development of the farm co-operatives. It is therefore included in the survey.

A moshav (pl. moshavim) is a co-operative village made of 60-120 member families. There are 411 moshavim in Israel. The farms in the moshav are private, but all farmers are members of the village co-operative and provided by it with local services: marketing, provision of inputs, finance and municipal services.

A communal moshav is a village where the farm or non-farm enterprises are run collectively, kibbutz style, while families own their dwellings. Members receive equal pay for working in the village enterprises, but run their own households privately. There are 45 communal moshavim in Israel.

Most of the secondary co-operatives are regional organisations, the members of which are either kibbutzim or moshavim (seldom both in the same co-op), the services they provide are produce collecting, sorting, storage, transportation, cotton ginning and financial services. One secondary co-operative, Tnuva, is the largest manufacturer of dairy products in the country. We will consider its case separately below.

Early History

Throughout their 2000 years in the Diaspora, Jews viewed Israel (then Palestine) as their holy homeland but only a small number actually lived in the country. For centuries, Palestine was part of the Turkish Empire, inhabited mostly by Arabs. The first waves of significant Jewish immigration and the re-emergence of Jewish agriculture are dated to the last third of the 19th century. A great part of the immigrants who then established agriculture in Israel were comparatively poor, had no capital of their own and were assisted, in their first steps, by national funds. Even before 1948, more than half the land area purchased for settlement was public. The legacy of national land was kept alive when many Arab farmers fled the country in the wake of the 1948 war and their land was taken by the state. Consequently, with limited exceptions, agricultural land in Israel is publicly owned and leased to cultivators at nominal prices on long-term basis. Naturally, national land and capital were more easily allocated to groups committed to agriculture, kibbutzim and moshavim, than to private parties who might have used them, or so it was feared, to further individual enrichment.

The first kibbutz was established in 1912 by a small group of young farm workers who chose communal life as a way to mitigate hardships and poverty. Ideology followed and many other kibbutzim were later established by people educated and trained for that purpose. The first moshav was established in 1921, aimed, at least partly, to provide a suitable framework for families wishing to settle the land without accepting the rigor of communal life. The communal moshav was a halfway solution.

Tnuva, the marketing co-operative, was founded in 1926. For years it had marketed all the farm products of co-operative agriculture in the country, but then it has gradually lost its market share in fruits and vegetables and has concentrated mainly in the collection of milk and the processing of dairy products. Regional secondary co-operatives were first established in the 1940s and grew in number and size as agriculture developed.

Functions

As indicated earlier, co-operatives, both in the moshav and the regionals, provided their members with marketing services, they also purchased wholesale farm requisites and operated sorting, packaging, transportation, and storage facilities. The most important service they provided was however financial intermediation. The co-operatives cultivated national land and, as the farm units were small (even in the relatively large kibbutz, but particularly in the moshav), they could not use their assets as collateral and lacked direct access to the capital market.

The instrument developed to replace the missing collateral was a set of mutual guaranties implemented at several levels: all members of a moshav mutually guaranteed credit the moshav co-operative raised—for joint ventures or to be distributed to individual farms. Similarly, moshavim and kibbutzim were guarantors to credit their regional co-operative associations raised. The purpose of mutual guaranties was to reduce the risk banks incurred in lending to co-operative farms and their secondary co-operatives. Experience reduced the subjective risk (the risk as seen by the creditors) even further: again and again, particularly in the 1950s and 1960s, the government bailed out kibbutzim and moshavim in financial difficulties. The assistance was usually provided in the form of government-backed, long-term loans replacing short- and medium-term credit. With inflation running high, a great part of the real value of this long-term debt was eroded before it was repaid. Co-operative agriculture flourished and banks were therefore not only willing to service agriculture, they were often eager to have co-operatives among their clients.

Credit raising became particularly easy during the 1970s when accelerating inflation was accompanied by ample supply of loanable funds in Israel—probably a reflection of easy access to world glut of petrodollars. The regional secondary co-operatives raised capital, relying on mutual guaranties, and channelled large quantities of credit to their members. They became financial intermediaries. Banks required mutual guaranties but, evidently, mainly relied on the government “that will never let co-operative agriculture fall”.

Expanded credit supply was not the only manifestation of inflation; another, not less important, was the erosion of the information value of financial reports. Though methods to adapt accounting practices to inflation were developed, their adoption was slow and both members of many co-operatives and their creditors did not really have accurate pictures of their economic performance. It seems however that lack of economic information did not deter the banks from extending increasing volume of credit to the seemingly safe co-operatives.

Crisis

By mid 1985 the accelerating inflation was reaching more 500 percent on an annual basis and the government felt obliged to bring it to an end. The change of direction came on 1 July 1985 with severe monetary and fiscal measures: price increases were halted and interest on short-term credit was raised to rates of up to 100% annually. A great part of the credit channelled through the secondary co-operatives to kibbutzim and moshavim was short-term and it had to be renewed at the higher rates. No business could stand such sky rocketing rates for a significant period of time and most of the kibbutzim, co-operative associations in the moshavim and the regionals became insolvent almost overnight. By mid 1986 it was clear that co-operative agriculture was in a deep financial crisis.

The crisis was triggered by the measures taken to halt inflation and was realised as financial insolvency but it had deeper roots. Four inter-related problems surfaced:

a. Lack of control. Secondary co-operatives and associations in moshavim transferred credit to their members disregarding their ability to repay loans on the terms received. Members in co-operatives, who mutually guaranteed loans taken by their associations, did not exercise the appropriate control over the actions of the officers running their financial affairs. Banks continued to extend credit to co-operatives that could not demonstrate stable economic and financial standing. And above all, despite some earlier attempts to limit the sector's debt, the government lost control of co-operative

finance. But banks and other agents continued to rely on the government's implicit safety net and neglected sound financial practices.

b. Diminished ideological commitment. Originally, members in moshavim, and particularly in kibbutzim, were highly motivated ideologically; they viewed themselves as pioneers in a national movement of the return of Jews to the land. National ideology and co-operative commitments reinforced each other. Members could easily be called to follow communal and co-operative norms of the kibbutz or the moshav: "Together we are building a nation". Once the state was established and its economy stabilised, the national argument for co-operation lost its force, particularly with the second and third generations who took the moshav and the kibbutz for granted and did not have the same zealous attachment to the original ideology their parents had. In the wake of reduced ideological commitment came a reduction in the adherence to old norms of action.

c. Moral hazard behaviour and free riding. Ample credit supply, mutual guaranties and reliance on the government to rescue co-operatives in trouble—encouraged moral hazard behaviour: farmers, co-operatives and kibbutzim, willingly went into debt to finance investment in production and consumption assets (particularly housing) even if repayment was far from assured. Moral hazard behaviour was not demonstrated only in the financial area: in the kibbutzim, loss of strict ideological commitment resulted in deteriorated work ethic, members were seeking easy tasks and short days. Increasingly, kibbutzim have been facing difficulties in getting talented and experienced people to undertake responsible tasks. Able young members either leave or go to work outside.

d. Poor economic performance. Easy credit and faulty control lead to poor economic performance in kibbutzim and co-operatives. Political and social considerations took precedence over efficiency and income. Survival was deemed secured with the government safety net. Consequently, when inflation was halted and rates of interest rose, many of the kibbutzim and the co-operatives discovered that they were operating

in the red. More than a few of their economic activities were making losses and the debts they accumulated were enormous and rising as interest charges continued piling.

Debt Settlement

As the crisis erupted, a great majority of the farm operators in the moshavim and many of the kibbutzim found that they were either themselves in heavy debt or they were guarantors of debt incurred by others—their peers and, particularly, the secondary co-operatives to which they belonged. Mutual guaranties were however meaningless under widespread breakdown; no one had the resources to pay anybody's debt. Moreover, the supreme court, where the problem eventually landed, freed the guarantors of their obligations; mostly on grounds that co-operatives were limited liability associations and as such members were responsible for the co-operative's debt only up to the value of their shares, which was very small.

The government found itself in a dilemma. On the one hand, it could not simply bail out the co-operatives as it had done previously—the magnitude of the crisis was beyond the state budget and the public would not have tolerated pouring large sums of money on the small farming sector. On the other hand, if unattended, the crisis could destroy co-operative agriculture and two or three of the largest banks in the country might have gone under with their debtors. The government had to step in. The question was how to allocate the losses and at the same time to secure continued functioning of agriculture.

Two separate major settlements were reached after long political debates. The settlement for the moshav sector took the form of a law enacted by parliament—parties both on the right and on the left had constituencies in this sector. The kibbutzim, on the other hand, were and still are identified with the left. Their debt settlement could not have been reached in the political arena; it was concluded as an agreement between debtors, creditors and the government.

The core of the settlements, both for the moshavim and the kibbutzim, is made of two-parts: (a) assessment of income potential of farms in moshavim and kibbutzim and rescheduling the part of the debt deemed repayable; (b) forgiveness of the debt that cannot be repaid. In the kibbutz sector, where the debt is larger, the government shoulders approximately a third of the loss; two thirds is taken up by banks and other creditors.

The settlement agreements were enacted and reached some ten years ago. Their implementation for the secondary co-operatives was relatively simple. In the moshav sector, these co-operatives closed and ceased operating; their assets sold to private parties. The secondary co-operatives of the kibbutzim have continued to function but in many cases in modest forms and none as financial intermediaries. Although the farm by farm implementation of the settlement agreements is not complete yet, the acute crisis atmosphere has calmed down. Still, the immediate consequence of the crisis was a significant change in the financial environment facing co-operative agriculture. Kibbutzim and farmers in moshavim have to deal directly with banks; they cannot rely anymore on familiar financial intermediaries. Operating on national land, the farms cannot serve as collateral and credit is provided only to units demonstrating sound economic basis.

The financial crisis was accompanied by a sharp turn in the terms of trade in agriculture; they have been worsening since the early 1980s. Today's real prices of farm products are only fifty percent of their level twenty years ago. The combined effects of the financial crisis and worsening terms of trade created a tight selection environment, particularly in the moshavim. Many left farming, some to seek off-farm employment others simply retired; production has concentrated in the hands of a relatively small number of operators.

Structural Changes

Moshavim, although originally co-operatives, may and do survive economically as villages of independent family farms. Reliance on collective provision of services and

finance was convenient, particularly in early stages, but present day's farmers will not accept forced co-operation. The role of the moshav association has been limited to mere necessities (collection of milk or municipal services); some associations were dissolved completely. But, the changes at the village level and in the co-operative association did not much affect the mode of operation on the individual farms. They were family units in the past and continue operating as such today.

Structural transformation in the kibbutzim seems to be more profound, painful and slow. A kibbutz is a commune; it is a community of people, an economic set of enterprises and a social entity. In the past, the community was not separated from the economic enterprises. As on a big family farm, members worked together in the economic enterprises—agricultural, manufacturing and services—shared consumption and housing and cared for their elders and children. The toughening economic environment, deterioration of the ideological commitment, spread of free riding and particularly, exit of the youngsters, changed all this. Some kibbutzim—especially those that through hard work, wisdom or luck attained economic wellbeing—still cling to the communal ideology and practice, but most are changing. The changes are gradual, many of the members find them hard to accept, and the road to reform is obstructed with economic, psychological and social obstacles.

A visitor returning these days to a kibbutz after 10 or 20 years of absence may not recognise any change: members go about their work, children to school, and people dine together—just as in the past. But most kibbutzim are undergoing drastic economic and social changes and many are searching intensely for a way to follow.

If one may extrapolate current trends, the kibbutzim are moving to become communities of individual households. If the reformers have their way, the emerging communities will be located in rural areas and the residents will choose either to be members in the kibbutz that will form the core of the community or to keep private household. Those who elect to be members will earn their living individually in the kibbutz enterprises or elsewhere and contribute community taxes at relatively high rates to supply social and welfare services, thus striving to maintain the mutual

responsibility principles on which the kibbutzim were founded. Starting in this direction, several kibbutzim are already introducing differential wages, many more are charging for services, which were for years supplied freely—members will not anymore receive identical basic budgets or consumption goods. Members are also encouraged to seek outside employment to expand sources of income. On another front, the kibbutzim are making preparations to register family dwellings as private property. Next they will probably transform the economic enterprises into limited liability companies with shares distributed to members.

One of the most difficult questions is the issue of retirement funds. When the kibbutzim were regarded as stable and successful economic units, it was thought that the kibbutz was strong enough to care for its older members from its own resources. As a result, kibbutzim did not contribute to retirement funds and are now finding that they lack the necessary basis for support of the older generation. Several kibbutzim solved the problem by accepting outside shareholders to their manufacturing enterprises and using the money received to establish retirement funds. But this route is open only to the few very successful manufacturing units. Kibbutzim in tight financial conditions will probably never solve the retirement problem. The fears of the older generations hinder significantly the efforts to reform the economic structure of many of the kibbutzim.

It is interesting to note that many kibbutzim turned to external professional help in the reform process. People that for two or three generations relied on internal, democratic collective decisions making are now leaning on outsiders to guide them through the new unfamiliar maze. The hypothesis I offer as an explanation starts with the observation that a significant, though perhaps not always recognised, aspect of the reform is a drastic change in the effect of collective decisions on the distribution of cost and benefits between the members. In the old kibbutz, consumption, dwelling, education, health care and other amenities were distributed on egalitarian principles. Most economic decisions—such as where to invest or what enterprise to develop—affected equally all members. With privatisation, most decisions have far reaching personal consequences: salary assigned to one group of workers or another,

pension benefits, registration of houses—all may affect favourably or unfavourably future individual wealth and income. Privatisation is therefore a painful process not only in drastically changing old ways of life but also in testing the delicate social fabric of the community of people living in the kibbutz. Professional guidance is now accepted where it would not have been dreamed of a few years ago.

The reform of the communal moshavim is relatively simple. The major change has been the introduction of differential wages in the collective enterprises and encouragement of members to seek outside employment. Families continue to maintain individual household as they have been doing all along.

Tnuva

Tnuva, recall, is a secondary marketing co-operative that grew into the largest dairy in the country. It collects close to ninety percent of the milk, distributes a third of it to smaller dairies and offers the largest selection of milk products in supermarkets and grocery stores. Although officially belonging to moshavim and kibbutzim, Tnuva was run independently for many years. Its management was appointed on political grounds and the leadership did not feel obliged to report to the membership. Its success owed more to sheer size and monopoly position than to economic efficiency. But successful it was. To maintain its leading position and fight off increased foreign and local competition, Tnuva had to become more flexible and efficient. In today's globalised markets, companies of Tnuva's size share knowledge and ownership across international borders. To operate effectively under these conditions, Tnuva has to become a joint stock company. I will not go into details here apart from indicating that the reform is already under way.

Concluding Remarks

A great part of the survey was devoted to the financial crisis and its aftermath. That emphasis was natural; the crisis was the most dramatic and traumatic economic event

agricultural co-operatives have experienced. The crisis hit hard, it imposed costs—in terms of interest charges and financial starvation—that even strong economic entities could hardly sustain, but it also revealed fundamental weaknesses in the structure and mode of operation of agricultural co-operatives in Israel. The agricultural co-operatives were never petrified; they were living entities, always changing to adapt to new economic, social and political environments. But the historical changes were gradual, evolutionary, while the reforms implemented in the wake of the crisis have been revolutionary. Many co-operatives, in the moshavim and their regionals, closed down and most kibbutzim can be expected to cease functioning as communes in the near or perhaps the distant future. Are these drastic changes due only to the crisis? Would we have still observed moshavim and kibbutzim functioning as co-operatives and communes, the way they had done for generations, had the anti-inflationary policies not been implemented?

In my judgement, the changes we have been witnessing would have come, perhaps on a different day, even if anti-inflationary policies had not been implemented and interest rates had not been raised to impossible levels. Moreover, even under more calm economic policies, the revolutionary reforms would have followed a financial crisis. Let me try to explain.

Basic to my explanation is the recognition that active business units, co-operatives included, invest money they receive, often through the banking system, from saving households. The savers and their agents in the banks earn interest but put their capital at risk. Once they suspect danger, they call the credit back and a financial crisis erupts. Having made this point, I return to our story.

The fundamental weaknesses referred to in the last section and described above—lax monitoring, reduced ideological commitments, free riding, moral hazard behaviour, youngsters leaving kibbutzim—had similar effects, they were all the roots and causes of economic inefficiencies. So long as credit flew essentially free, new money kept covering old losses. But this could not have lasted forever, one day the government's safety net would have been tested and found lacking (worsening terms of trade could

have been the trigger) and “suddenly” the realisation would have dawned that the co-operatives could not cover their debts. Such a change in perception would have then ignited a financial crisis: banks would have stopped lending and call outstanding loans back, co-operatives would have fallen into arrears and bankruptcies would have followed. The revolutionary changes in agricultural co-operatives must have been implemented; basic shortcomings must have been corrected. But so long as credit was easy to come by, difficult reforms could be postponed. It takes a crisis to implement even necessary changes. Whenever drastic reforms would have materialised, it would have been in the wake of a financial crisis.

Should one conclude from the recent experience and changes that agricultural co-operation in Israel was a failure? I cannot be party to this conclusion. For years, co-operation and collective action were the instruments of development of agriculture, from traditional to modern—this was not a failure. To my mind, the lesson to be drawn from the experience surveyed in this paper is that institutions have to adapt on time to changing circumstances. Inefficient secondary co-operatives have to close down and successful large organisations have to turn into business-like limited liability companies, owned by the public and subject to the discipline imposed by the stock market. It should also be remembered that, even after the reforms, there is still room for a great deal of co-operation in agriculture where the typical economic units are small relative to the suppliers of services in the product and input markets. The future will tell whether the spirit of co-operation is still alive and the institutions of mutual help can be reconstructed on a sound economic and social basis to the benefit of members and communities.

April, 2000