CHAPTER 1

Analysis of Institutions:
A New Lens to Rural Policies and Agricultural Markets

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Abstract

This introduction chapter questions why institutions matter for the organisation of the rural policies and agricultural markets and why the sector is an interesting case for institutional economics. Given decreasing market support, new consumer concerns and the widening of policy scope to rural development, it is stated that the interplay between policies and institutional arrangements becomes more important. The complex institutional system of multi-agency, government interaction and the specificity of its goods makes the sector attractive for new institutional economics research. Three main areas of interest structure the book: policy implementation, market and supply organisation and management of natural resources and rural systems.

1.1. DO INSTITUTIONS MATTER FOR THE ORGANISATION OF THE AGRO-FOOD SECTOR?

The agro-food sector is always being confronted with major challenges. This book presents new analyses and reflections about the future organisation of the sector. The link between the political, rural and social systems on the one hand and market organisations on the other is placed within a neo-institutional economics (NIE) point of view. Neo-institutional theory presents an alternative lens to look at economic realities and allows, according to Williamson (2000), to distinguish between social rules (formed by tradition, old organisations, ...), the legal and policy framework and the institutional arrangements
that are formed to organise transactions. Within this framework, public governance or policy can be defined as finding the right balance between the institutional environment created by formal and informal rules and the institutional arrangements that emerge as a result. Both levels interact and result in the specific organisation of a sector or social system. Further in this book, Mittenzweig and Bullock, Chapter 7, explicitly and formally deal with the interaction between institutional environment and arrangements.

With less market support and more emphasis on new consumer concerns, this interplay between policies and institutional arrangements becomes even more important. An example is the evolution in food safety control over the last few years. In the past, food safety was seen in most countries as a major State responsibility. The State had to set up the rules and standards and to organise the control itself. After the recent food safety crises, the State became aware of the fact that command-and-control measures alone do not work sufficiently to avoid problems, but that incentives needed to be given for the sector to control itself. Gradually, a shift has occurred towards auto-control and traceability systems, established and managed within the sector. This has of course a major influence on the contractual arrangements between the different stakeholders in the food chain and for the role of public authorities, which has been increasingly shifting to a “control-on-the-control” system (see also Hobbs (2003) and Chapter 13). The fact that the social environment also influences this process is indicated by the difference in approach between the Nordic and southern EU member States, for example.

Liberalisation of trade is another driving force changing the rules of production, trade and marketing. This will also lead to new organisational forms, which already become apparent in the emergence of new contractual forms between the production, processing and retailing sectors, new market organisation instruments and new ways for channelling support to the rural sector (e.g., for the provision of public goods).

NEIE provides theories looking through a specific lens to problems of organisation, whether they are economic, political, social, legislative or informal. Williamson (Chapter 2), one of the founder fathers of transaction costs economics (TCE), an important branch of NEIE looking specifically to contractual problems, also uses the lens metaphor. He states that TCE is one (and he clearly indicates that it is not the only one) of the lenses to look at economic organisation, as a departure from what others may consider as “proper course paradigms”. NEIE and TCE allow a better understanding of the development of organisation of sectors or society because they address fundamental issues of governance that are central to an understanding of complex economic organisation and good public policy. Eggertsson (Chapter 3) uses the term “subtle art” when speaking about institutional reform to indicate that it is the interplay of transaction costs, political economy and incomplete knowledge that shapes major institutional reform. NEIE looks at the facts, sometimes starting from micro-analytic details (Williamson, Chapter 2) and employing a rapidly increasing set of theoretical and practical tools fruiting from a multi-disciplinary fecundation. According to Klein (2000), NEIE is therefore seen as a broadly sensed discipline, covering economics, law, organisation theory, political science, sociology and anthropology.

Aoki (2000) approaches NEIE as a tool to analyse the economic “game” with his multiple agents as players, each searching for their own interests given their institutional (rules) and non-institutional (technologies and factor endowments) factors, but seeing new
rules, new equilibria emerging from their strategies and decisions. “Game boy” playing kids are indulgent in reaching as many “levels” as possible; NIE players always commute between the levels of institution-as-rules and institutions-as-equilibria. The outcome of the one is the input of the other and do not necessarily coincide with the static description mentioned above of institutional environment and arrangements.

As indicated by North (1994, 2000) and Ménard (1996) institutions really do matter and can make the difference for development and economic change. This has also been recognised for world agriculture by inter alia Kydd et al. (2002); World Bank (2002) and Dorward et al. (2003). Based on empirical evidence, Cherchy and Watteyne (2003) even conclude that institutions are a more fundamental determinant for economic development than other factors such as the integration of a country within the world economy. Agricultural development is not possible without providing stakeholders with some basic certainties embedded within a self-controlling local society and property rights structure. Farming, hunting and fishing rely on clearly defined property rights enforced through formal and informal institutions. Technical progress, scale enlargement, increased risks and overall industrialisation of the agricultural process need—and set—new conventions. In Western societies, where agriculture is entering the post-industrial era, agricultural development will mainly depend on the ability to respond to new consumer concerns and citizens’ claims vis-à-vis the rural area, in what is also proven to be a mainly institutional issue (see inter alia Ménard, 2000; Van Huylensbroeck, 2003). From the perspective that the matching of economics and organisation theory caused a major breakthrough in the understanding of how economic systems work, the question is no longer: “does organisation matter?”, but “why and how does organisation matter?” (Ménard, 1996).

1.2. AGRICULTURE: AN INTERESTING CASE FOR INSTITUTIONAL ECONOMICS

Because institutions do matter for agricultural development, it is not surprising that agricultural economics (in the broad sense covering disciplines such as rural sociology, farm and chain management, agricultural policy,...) and some adjacent disciplines (such as political economy and resource economics) start to pay increased attention towards them. Agriculture is indeed a complex sector with important societal implications (food and amenities supply) embedded within a broader rural system. Furthermore, the agricultural sector is a multi-agent sector with a complex chain of inputs, intermediates and output markets. Finally, due to its societal implications, it is a highly regulated sector. There has been a strong normative belief that government could intervene and correct market distortions and, thus, could shape the economic (safeguard the food supply) and social (income guarantee) reality.

Multi-agency and strong government regulation bring forth a complex institutional system. As a consequence, agriculture has become the playground for important changes within the institutional environment. Shifts from market interventions to rural policies, internalisation of external effects and co-governance of resources have triggered the need
for new economic approaches, complementary to the orthodox way of thinking in terms of full information, rationality and market efficiency. As explained in the first section, NIE is a comprehensive tool that enlarges understandings of current developments in agriculture and its surroundings.

The aim of this volume is to bring a selected state-of-the-art of the conceptual and empirical NIE-inspired research by European agricultural economists. The chapters are mainly selected from two perspectives. The first one is to demonstrate that institutional economics can contribute to the understanding of how rural policies, the rural social system and agricultural markets are organised. The second objective is somewhat more ambitious and is to illustrate that analysis of rural institutions can contribute towards the development of the NIE framework and theory.

Agricultural economics and policy analysis have mainly relied, so far, on what Williamson (Chapter 2) calls the orthodoxy of the neo-classical framework. Agriculture in the past has often been presented and used as an ideal observation field for testing hypotheses derived from this theory. The work of the main authors of the (neo-) classical school often refers to agricultural products or markets. The number of NIE applications to agricultural development problems today is increasing. This book is an illustration of this growing field. There are two reasons why this increase in interest is not surprising. One is that agricultural products have a number of characteristics different from industrial products requiring specific contractual arrangements and institutional frameworks. Williamson refers in his contribution to the perishable nature of agricultural products, but other contributions refer to credence or other unobserved features of products, which make special market arrangements necessary. The second reason is one indicated by Eggertsson (Chapter 3) and many others in this book: the high complexity of policies and property rights structures within the agricultural and fishery sector. The fact that the rural sector has many small producers, often with weakly defined property rights with respect to natural resources and high transaction costs to change the policy system, makes it an ideal observation field for verifying and testing new hypotheses and theories in NIE. This is particularly true with current major changes such as the one from a collective to a more market-oriented system in transition countries, the implementation of the mid-term review of the common agricultural policy (CAP), the difficult shift to trade liberalisation and the emphasis on new roles of agriculture. Many contributions in this volume are, therefore, at the edge of conceptualisation of NIE concepts, theory application and pure empirical analysis. Verification of these theories is very important for a discipline where a mass of evidence is waiting to be lined up by a theory, or “waiting for a fire” (Coase, 1984). Agricultural economists may bring a lot of empirical evidence, and in this sense contribute towards the further expansion of the theory.

1.3. STRUCTURE OF THE BOOK

1.3.1. Policies, markets and rurality

The title of the book tries to capture the main subjects. Besides the social environment, the two main components of an actor’s institutional environment are policies and markets. For
a farmer, as an economic producing actor and social agent, his environment comprises politics, markets and rurality, of which the first is seeking to get more ordering in the two others. Furthermore, the term “rural” in the title tries to capture, both in policies and markets, the usual agricultural activities as well as the new ones, more oriented to the rural social system. Rural has thus a double connotation, referring both to the policy and market environment and to the geographical and social area where agriculture traditionally exerts its property rights. The title should hence not only be interpreted as an unidirectional link with institutions tailoring policies and markets. The implicit idea is that also policies and markets are continuously changing and, therefore, need new or other institutions. As has already been indicated, the perspectives on institutions-as-rules and institutions-as-equilibria are closely inter-related.

The book is thus oriented to three main areas of interest in institutions: policy implementation, market and supply chain organisation and management of natural resources and rural systems. These three areas are used as the first entrants for structuring the book, but as they still cover broad interests, they are further divided in sub-parts. Within each block, other structuring elements have shaped the book structure, as will be explained.

In the first area of interest, policy implementation, a great deal of attention is paid to formalising insights within policy formation and application, complemented with more empirical work. Additionally, a part is dedicated to knowledge production and exchange in policy analysis: how to deal with the actor inter-relationships and organisation in policy analysis. This can be illustrated with the following example of the dairy sector. Although all EU countries fall under the same quota policy, highly different systems among EU countries can be observed with respect to the practical application rules, the transfer of quota, for example. Countries such as the Netherlands or Great Britain have a very liberal system of quota transfer while countries like Belgium or Ireland have a highly restrictive quota transfer system. The rules have a high impact on the development of the dairy sector in these respective countries with large-scale farms in the first and much smaller farms in the second group of countries. It is also clear that the different arrangements among countries can only continue because of the policy decision to keep fixed quota shares per country. This is in turn the result of political institutional decision and enforcement rules. Different examples in the policy block illustrate the complex interplay of different institutional levels and rules.

New rules may also act as a catalyst for the development of new markets, a second area of interest: institutions in marketing and supply chain management. New arrangements in the food sector established for food quality and safety reasons have already been referred to above. The growing interest of consumers in more sustainable forms of farming and food production have also created new market outlets. The problem is that a lot of the desired attributes are credence attributes that can not be readily observed or experienced by consumers. In situations where product differentiation is relatively low and increasingly based on credence quality, issues like information and consumer trust prevail. Market segmentation and product differentiation on the basis of such attributes require new arrangements and mechanisms such as certification, quality assurance, labelling and traceability systems. Such systems are often too costly for individual farmers and controversy prevails as to its potential rent for producers and food
chains. Keeping up with these demand-led evolutions requires new kinds of institutions and organisations, aimed at improving market conditions and lifting potential market failure. Besides the applications of NIE aimed at understanding what is happening in the food chain, like contracting, risks, vertical alliances, a number of contributions deals with capital and land market arrangements, or in other words with the organisation of the input markets.

The third area where institutions play an important role is in the field of natural resource management. It is clear that property rights and transfer rules play an important role in access to land, water and other natural resources and may lead to under- or over-utilisation of them. A lot of externality problems in EU agriculture have to do with the lack of definition of property rights or of institutional arrangements allowing proper use of common pool resources, for example. Public authorities have also in this case to find the right balance between on the one hand legislation and command-and-control measures and giving incentives to stakeholders to find their own solutions on the other. New rules may also create new property rights. License policies or management agreements, e.g., may have as an unintentional effect that practices previously applied by farmers for free are receiving a price which can be capitalised on. Uptake of management agreements will also be completely different depending on the rules and requirements to be fulfilled.

The capacity of self-organisation will highly depend on collective action and social capital. Incomplete social models may lead to inertia and resistance to the changing environment, but social capital can be exploited when appropriately recognised (bottom up approach) as is illustrated in a number of contributions.

In the following sections is explained how the different chapters contribute to the structure of the book.

1.3.2. Part 1: TCE, a state-of-the-art

The book opens with a contribution by Olliver Williamson who offers an excursion into the wonderful world of transaction cost economics (TCE). If the child who we call TCE is coming from Coase (1937), Williamson has given it a name and allowed it to grow up. He is, therefore, the right person to remind us of the principles of TCE. His excursion starts by reflecting on some points of criticism in orthodoxy and on the inter-disciplinary ideas, which are at the basis of TCE. Then it turns to the TCE conceptualisation and operationalisation and ends with the links to agriculture. Williamson not only invites the agricultural economists to use NIE and TCE, but also to contribute to its further development, reminding us of the major scope of this volume.

1.3.3. Part 2: Policy reform, institutional determinants and outcomes

One of the most important features of new institutional economics is that it provides a complementary lens to economic science, a viewpoint that structures a mass of empirical evidence. This is also the case when trying to understand policy reforms and their implications. As opener to this part, Eggertsson gives a comprehensive analysis, using the
Iceland fishing industry as a case study. The process of changes might be so dramatic and multi-dimensional that coping with it requires major social reform. The outcomes of major institutional changes may remain uncertain. Eggertsson ascribes this to the fact that policy models are based on incomplete social models. But, incomplete social models would be of minor importance when social experiments yield reliable data. This is mostly not the case, so knowledge may stay incomplete due to unreliable feedback. In his chapter on property rights introduction within the Icelandic fisheries, the country’s key industry, Eggertsson illustrates how transaction costs, political economy and incomplete knowledge may shape major institutional reform.

In this sense and staying in fishery terms, Eggertsson’s contribution can be seen as a flag-ship for the three chapters that follows. These are dealing with major institutional changes in agricultural and rural policies: the accession of East European countries to the EU, the reinforcement of the decisive power of the EU parliament (EP) and the modulation of direct payments in the EU CAP. These contributions describe the institutional determinants of the change process, but from sheer necessity, must remain speculative on the outcomes. The role of existing institutions in policy reform is treated in two contributions. Erjavec (Chapter 4) analyses the role of national and multi-national institutions in the EU accession negotiations while Chatzopoulos (Chapter 5) wonders what the effect may be of changing the EU decision rules (the co-decision instead of the consultation decision-making procedure) on future CAP reform.

The institutional framework, used by Erjavec to describe the role of European and national institutions on the negotiation process and outcomes, entails three political science models: the inter-governmentalist theory, the multi-level governance and the European bureaucratic politics concept. The analysis, illustrated with the main negotiating issues (quota, direct payments and rural development funds) suggests that as negotiations were incorporated in the usual decision-making system, the candidate countries gradually took over the typical EU organisation and functioning methods. With respect to the shift in the EP role from a consultative to a more decisive actor, Chatzopoulos concludes that an EP with more decisive power in CAP matters would bring more transparency, democracy, acceptance by stakeholders and dynamism to CAP reforms. Applying co-decision to CAP will, however, also increase complexity and competition with other EP responsibilities, but the author does not really pronounce on a possible decreasing effect on agricultural protection. Henning (see further in Chapter 9) find other intrinsic features of the decision-making process that allow to judge that protection may remain high (or at least that changes will be limited in relation to the status quo).

Henke and Sardone (Chapter 6) treat the re-orientation process of the CAP support towards modulation of direct payments. This new policy instrument channels funds from the usual market support (first CAP pillar) to the provision of public goods (second CAP pillar). Compared to the two previous contributions, not only is the impact of existing institutions on the reform process demonstrated, but also the need for new arrangements is highlighted as a process outcome. On the one hand, some institutional aspects of the change process are given, in particular those with respect to the introduction of an innovative policy instrument. On the other hand, the new policy implementation will also cause a shift in managerial responsibilities at various institutional levels.
1.3.4. Part 3: Formalisation of the links between institutions and policy

The new institutional approach can also be formalised. While existing political economy models mainly focus on economic and political determinants of policies, formal and informal political institutions have until recently been neglected, in attempts to clarify, for example, differences in agricultural protection. Moreover, formal models explaining these empirically observed differences in terms of institutional determinants are scarce. In this book, this gap is covered by four contributions, among them two that use game-theoretic models. Stylised or formal modelling of political institutions and their role on policy outcomes helps to understand phenomena like status quo and inertia in institutional change. Furthermore, if one really wants to trigger changes in the institutional environment, models may help to get insights in those factors that hamper or stimulate institutional change.

One game-theoretic model is given by Mittenzwei and Bullock in Chapter 7, and starts from a two-level framework reflecting the two dominant views on institutions: institutions-as-rules formalised as the institution-dependent level on the one hand, and the institutions-as-equilibria view formalised as the institution-forming level on the other. The model is applied to the specific situation of Norwegian agricultural policy making, in which the farmers’ organisations have a direct role. For more than 50 years, the agricultural policy decision-making in Norway grants the farmers’ organisations the legal and exclusive right to negotiate with the government about direct budget support and administrative prices. This chapter not only provides theoretical evidence that viewing institutions as both rules and equilibria facilitates comparative institutional analysis, but also identifies, on the applied side, several reasons for the persistence of agricultural policy formation in Norway.

The other contributions look at the more unidirectional role of institutions (in particular voting rules) on policy making. The persistence of an inefficient CAP is the main research topic and leads to questioning what the determining factors behind this institutionally complex problem might be. Pokrivcak and Swinnen (Chapter 8) have worked out a formal model including the two stages of the CAP decision-making: the stage of determining the states’ preferences and the joint decision-making stage at EU level. The model is used to analyse the dependency of the final policy decision under different institutional assumptions, such as the voting rule. The authors conclude that the power of the EU Commission increases under the qualified majority vote system, but at the same time the risk of a stalemate becomes high. In order to get out this status quo situation, package deals may be used, which again may extend the EU Commission power. Henning (Chapter 9) looks at the impact of the legislature organisation on the level of agricultural protection. This is first supported with a literature overview, then worked out with a simple game-theoretic model and finally tested against empirical evidence. In particular, the different decision-making rules in the EU and USA are analysed. The model approach gives a framework to analyse different future situations, e.g., the increasing legislative power of the European Parliament would have no impact on agricultural protection, which provides a more precise completion to the more empirical conclusion of Chatzopoulos in Chapter 5. A similar work on the role of political institutions in shaping agricultural policy is given by Opper en Raimondi in Chapter 10. Using econometrics, they test some
theoretical hypotheses on the possible effects of electoral rules and government forms on dairy policies. They found that the transfer level to the dairy sector is significantly lower in majoritarian and presidential regimes than in proportional and parliamentary systems. Because agricultural policy choice can be seen as an example of narrow target programs, Olper and Raimondi also concentrates on the impact of the geographical concentration of farms on the observed institutional links with the policy choice outcomes.

1.3.5. Part 4: Institutions in policy analysis

As Eggertson stated in his contribution, uncertainties about outcomes influence the institutional reform process, both on the government decision-making side as well as on the public perception side. Decreasing uncertainties when preparing a new policy can be obtained through a more agent-based or agent-oriented policy analysis. This is possible through two approaches. One takes into account the occurrence of agents and institutions in a neoclassical policy analysis framework. The other looks at the institutional arrangements in which the inputs and results of policy analysis can be exchanged. The argument is that these two pathways have to be followed simultaneously if one really wants to deal with institutions in policy analysis. The two contributions give practical examples of both approaches. Happe et al. (Chapter 11) use an agent-based model with focus on the possible outcomes at the level of the individual actors and co-ordinating institutional interactions. Whereas the more traditional policy analysis is interested in optimal resource allocation and profit maximisation at an aggregated level and ignores the existence of institutions, the methodology presented by Happe et al. has a strong micro-analytic nature and the potential to describe inter-agent relationships. The model is applied on simulations of the land market. The method also allows for inter-disciplinarity, in particular how to cope with expert knowledge. Fernagut et al. (Chapter 12) go one step further and question how expert knowledge and policy analysis interfere and what kind of institutional arrangements can favour this integration. They describe the embedment of their agent-based sector modelling in the knowledge exchange arrangements between researchers and policy makers. From the various theoretical knowledge exchange models or paradigms, a highly participatory approach is recommended. A communication facilitator is proposed as a vehicle to increase the actual participation of stakeholders in the policy process.

1.3.6. Part 5: Market metamorphosis and chain dynamics

One of the most important topics in NIE with respect to agriculture is the organisation of the exchange of agricultural commodities. As Williamson states in his opening chapter, the individual farms are too small for forward integration into processing. Moreover, new consumer concerns necessitate new batteries of control and market institutions.

This part is opened by Hobbs (Chapter 13) who presents a state-of-the-art chapter, taking newly emerging consumer concerns, growing interest in credence attributes, and the reality of increased information asymmetry as the starting points for investigating the role of TCE and NIE. Food safety issues, food quality issues and technological change
are discussed as catalysts for institutional adaptation. Firstly, cases in safety pertain to BSE, food-borne pathogens and zoonotic agents. Secondly, grading systems and quality assurance programmes are discussed as food quality cases probing institutional adaptation. Thirdly, genetic modification performs as the ideal showcase for analysing institutional adaptations in response to technological change in agriculture and food chains. The contribution ends by stressing and challenging the role of policy institutions and policy making to create and facilitate optimal conditions for the flexible adaptation of the institutional environment to newly emerging market demands.

Weaver and Wesseler (Chapter 14) build further on the issue of food quality standards and the emergence of food system value chains and analyse their implication for policy. With a conceptual model, transactions through a traditional competitive market are compared with those through a value chain with contractually formalised quality standards. The conclusion is that introducing the value chain system is not scale-neutral, which has major implications for agricultural policy making.

In a similar vein, Balman and Mußhoff (Chapter 15) model and analyse transactions using spot markets versus vertically integrated chains in a real options framework, with the specific objective of assessing effects in terms of investment reluctance. The conclusion from an empirical investigation using pork price data is that the sport market and the closed chain system lead to the same production dynamics at least in case of sufficient investment strategy and production capacity awareness among producers operating on the spot market. The authors explain how this finding is in accordance with the real options theory and what the implications are for policy intervention.

Réviron et al. (Chapter 16) explore specific producer benefits of vertical alliances versus conventional markets. The specific case at hand pertains to the Gruyere cheese protected designation of origin (PDO) alliance in Switzerland. The authors start with a critical analysis of theoretical economic models for the analysis of real markets and further verify whether the assumptions of the neo-classical model for a conventional and PDO supply chain are correct. They show that this is not the case and that the NIE lens is more powerful to understand the emergence of vertical alliances. Their analysis shows that vertical alliances, on top of contributing to multi-functionality in rural areas, allow the removal of certain imperfections of conventional agricultural markets.

Kuwornu et al. (Chapter 17) apply the classic agency model to investigate risk shifting and chain reversal in the food supply chain. The empirical application to the Dutch marketing channel of ware potatoes shows that risk has been shifted over time from intermediary chain participants, e.g., retailers, to the potato growers themselves. This analysis stresses the importance of incorporating several stages of the marketing channel into future analyses, and extending the classic agency model accordingly.

1.3.7. Part 6: Arrangements in input markets

Orthodox neo-classical economics, looking to optimal resource allocation given technology and factor endowments, ignore the institutions behind the decision making unit. In agriculture, it is in particular family farms that are facing a changing economic environment. What holds with respect to scale economies towards the output, i.e., the
processing and marketing side, also applies for input markets. Arrangements become necessary to provide farmers with adequate access to resources like capital, land and technology. These questions are particularly relevant when formal rules are or have been changing as exemplified by recent evolutions in Central and Eastern European Countries.

Petrick (Chapter 18) investigates the role of government intervention on local agricultural credit programmes in Poland. After reviewing theoretical controversies regarding government intervention on markets with agency relations, a micro-econometric analysis of the Polish agricultural credit programme is performed. The analysis highlights current imperfections in the arrangements, more specifically a mismatch between the policy instrument and the actual problems on the loan market drawing important lessons that policy advice must take current political constraints into account.

Foreign investment may bridge the gaps left by local agricultural credit programmes, as shown by Dries and Swinnen (Chapter 19). They analyse the induction of institutional restructuring after the opening of the Polish economy to inflows of foreign investment, know-how and technology. Their empirical survey-based analysis shows that foreign companies have introduced farm assistance programmes along with investments, as part of a process of vertical integration. This has resulted in rapid vertical and horizontal spillover effects with a beneficial impact on access to finance, investment, productivity and product quality among small local suppliers.

Vranken and Swinnen (Chapter 20) discuss institutional arrangements in the land market. Their empirical analysis of farmers’ choice between renting or buying land indicates that the existence of a rent market has allowed less-endowed but well-educated farmers to have access to land and increase their farm size. Nevertheless, transaction costs are still high, in particular for farmers who do not have strong links with former (and still heavily influential) co-operatives. Hence, the institutional environment still needs improvement in order to allow a good functioning of the land market.

1.3.8. Part 7: New institutions in agro-environmental policies and public good delivery

NIE not only provides an extra lens to political economy, policy analysis, chain dynamics and factor demand, but in particular becomes very useful when analysing agro-environmental issues or elaborating institutions for public goods delivery by agriculture (multi-functionality). Externalities and public goods are associated with high transaction costs. Incomplete property rights and serious institutional failure are the keywords that Eggertsson uses when he describes the mismanagement of the open-seas fisheries. Internalising external effects, favouring multi-functional development of agriculture and the co-habitation of the agriculture sector with other functions in areas where agriculture had almost exclusive property rights, need new rules and enforcement (Hagedorn, 2003). However, different forms of inertia may slow down these evolutions.

Two more general chapters show there is still a long way to go. With the lessons of Williamson about the different lens of TCE in mind, Fahlbeck (Chapter 21) shows how the characteristics of non-excludability and non-rivalry receive another meaning when
analysed from NIE and TCE perspective. He also emphasises the inertia in agro-environmental policies caused by the asset specificities created by old policies in bureaucracy and existing institutions. This explains why politicians in most cases prefer regulative policies rather than policies that give incentives to explore the jointness in production of commodity and non-commodity goods and to modify the excludability of public goods. This requires important institutional change and a re-orientation of agro-environmental policies.

Ortiz-Miranda et al. (Chapter 22) analyse the role of agro-environmental measures in both the definition and characterisation of property rights. Depending on the position taken, different interpretation can be given as to how agro-environmental policies define property rights. A first interpretation accepts that farmers in the past had unlimited rights to use natural resources because there was no legislation preventing it, hence each extra constraint put on it is regarded as a limitation of the property rights of farmers. In a second interpretation, putting limits on natural resource use is regarded as a first time definition of the rights of farmers and thus issues property rights that in the past where non-existent. It is clear that the interpretation followed is important for agro-environmental policies; are they allowed to set environmental standards without compensation or must they be based on remuneration of activities regarded as positive contributions to society. New agro-environmental policies must therefore be carefully selected because they implicitly establish a new property structure, which may become a restriction for future treatment of environmental problems. A balance must be found between private and social security (or certainty) on the one hand and private and social flexibility to react on new developments on the other.

The interaction of current institutions and agro-environmental policies—or the low flexibility of policies to allow for new arrangements—is illustrated with three other contributions. Deuninck et al. (Chapter 23) describe a new policy instrument in the Flemish nitrate policy, the buy-out of livestock production capacity. The problem in this case is that the government, besides its role as rule-setting actor has become a transaction partner in the nitrate market. This has triggered the emergence of new competing arrangements between pig holders and feed companies that have turned out to be more efficient, making the original policy instrument non-effective and more or less redundant.

In Chapter 24, Gatzweiler and Hagedorn show that the implementation of agro-environmental policies in the new member states of the EU poses major challenges. The mere adaptation of national legislation to EU rules and directives is insufficient. The implementation of such highly complex policies and regulations also requires sufficient human and social capital and adapted formal and informal institutions. The examples show that this capacity is lacking in these countries, a thesis that is further illustrated by the case study described by Ratinger et al. (Chapter 25). They analyse the weaknesses of the current institutional arrangements to protect biodiversity and landscape in the White Carpathian area in the Czech Republic. Their discussion and analysis of different policy options to improve this protection indicates that the outcome depends on a redefinition of the role of public authorities. If property rights are given to the public authorities, other arrangements than under private property rights are necessary. In this last case, new institutional arrangements will emerge with a higher need for collective action and social capital.
1.3.9. Part 8: Role of social capital and bottom-up approaches in rural development

The chapters about agro-environmental policies already indicate the importance of social capital for adequate institutional change, in particular in the case of complex policies. Part 8 is about social capital and the possibilities of social-capital-based institutions. When the assumption holds that institutions, people and the organisations behind economic activities matter, social capital becomes important in leading the reform process. This requires new methods for guiding and structuring changes in economic and social systems and in particular in complex rural systems involving many stakeholders. Growing evidence on the important role of social capital had led to an expansion of participatory or bottom-up approaches in various development or change processes.

The four contributions in this last part of the book can be read in a logical order. Valentino concentrates on social capital and describes “what it is” and “what it can do”. Wolz et al. further explore the “what it can do” question while Korf critically reflects on the possibilities of participatory approaches. Finally, Delgado et al. illustrate the existing tension between official top-down and bottom-up created institutions.

Valentino (Chapter 26) defines social capital and investigates whether its incorporation in existing political economy, property rights and TCE theories may increase their explaining power. He defines social capital as the shared knowledge, trust and culture embodied in structural networks and other inter-agent relationships. The assignment of property rights influences the allocation of resources and any given assignment can result in different allocations depending upon how much social capital is available within a community. He, therefore, introduces the term “social-capital-based institutions” (all forms of collaboration among farmers) as opposed to “authority-based institutions”. Valentino argues that because of the existing tradition of co-operatives in CEE countries, social-capital-based institutions may prove to be a better solution than authority-based institutions in these countries.

Wolz et al. (Chapter 27) agree with the hypothesis of social capital as an important factor of institutional change. He defines social capital as the ability to co-operate. This has not only to do with available human capital (education, knowledge) but also with the existence and possibilities of self-organisation. This was lacking in transition countries in the past, which may explain their poor performance in terms of social capital, although empirical evidence provided clearly indicates a relation between the participation in organisations and farm income. Transition countries should therefore increase possibilities for self-organisation both by creating a legal environment for such organisations and by stimulating participation.

Korf (Chapter 28) makes a critical analysis of the possibilities of bottom-up approaches in rural development. Based on experiences both in less developed countries (LDCs) and in Western Europe, critical success factors for participatory approaches are identified such as institutional embeddedness, low transaction costs of participation, equal distribution of outcomes of negotiations and a local impact radius. If participation is understood as negotiated institution building, then from a theoretical point of view the legitimacy of such approaches can be questionable, in particular when transaction costs and other factors have an influence on participation. While formal State institutions derive
legitimacy from the constitution, this is not the case for open forums. Therefore, Korf argues that the dilemma of bottom-up approaches is that in theory they can only be advisory, but reducing their binding character decreases participation levels and thus legitimacy.

Delgado et al. (Chapter 29) also focus on that point by analysing, for Andalusia, by analysing the co-existence within the same territory of bottom-up created institutions for the development of rural areas and top-down official rural development organisations. They speak about a leadership conflict between institutions. By looking at the differences in territorial boundaries and working area between both types of institutions, they analyse whether they are co-ordinated. This is not always the case and indicates that there are still major difficulties in harmonising both approaches.

1.4. EPILOGUE

Utilising Williamson's metaphor of an excursion, we hope this book may be as an interesting journey for all readers throughout NIE and TCE research applied to the complex rural world. Hopefully the book provides for many readers a new lens on this complex reality. We are convinced that an NIE approach contributes to our understanding of this reality and can enrich other explanations given. Whether the book succeeds in its double mission mentioned in this introduction is up to the reader. As editors, we hope that it at least contributes towards the understanding of the complex social phenomena in the rural sector because we are convinced that the further development of the agricultural and rural sector will also depend on our ability to analyse, develop and construct new institutional responses and social models.

REFERENCES


