

**In Search of the Market:  
Lessons from Analyzing Agricultural Transition  
in Central and Eastern Europe<sup>†</sup>**

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# **In Search of the Market: Lessons from Analyzing Agricultural Transition in Central and Eastern Europe**

## **Abstract**

Studies of the transition process remind us of Stiglitz's comparison between pathology and the economic analysis of institutions (1989): asking what went wrong and what did not is the essence of understanding the functioning of social systems. Thus, carefully conducted empirical studies of the transition process itself may yield elucidative results applicable not only to theory but also to institutional policy changes in transition.

This paper presents the key findings of KATO, a comprehensive research project focussing on the transition process of agriculture in Central and Eastern Europe. From 1997 to 2000, the project empirically examined processes of liberalization and market development, privatization and property rights changes, as well as restructuring and path dependencies in three Central and Eastern Europe countries: Poland, the Czech Republic and Bulgaria. Conclusions on three analytical levels are drawn: (1) the empirical design for analyzing rapidly changing and evolving institutions in transition economies, (2) the suitability of different theoretical approaches for understanding transition, and (3) policy recommendations targeting better governance and an improved institutional framework.

# In Search of the Market: Lessons from Analyzing Agricultural Transition in Central and Eastern Europe

## 1 Introduction

The analysis of the transition process currently taking place in Central and Eastern European Countries (CEECs) reminds us of Stiglitz's (1989) prominent comparison between Pathology and Economics: finding out what went wrong provides us with a better understanding of the development of living systems. Thus, the analytical understanding of transitional institutional change represents a challenging task for the relatively young disciplines of the New Institutional Economics and related areas like the New Political Economy. How to empirically approach the varying outcomes of the undertaken institutional reform experiments? How to identify the appropriate theories in order to decompose the complex dynamics of political and economic reforms and how, at the end of the day, to disentangle complex findings in order to give straightforward policy advice?

These questions characterize the basic idea behind the KATO research project, which explored the transition of the agricultural sectors in Poland, Czech Republic and Bulgaria by applying different theoretical lenses and empirical instruments on different levels of institutional analysis. The starting point of our research was the hope of finding common patterns of change by comparing the privatization of land and assets, firm restructuring, and market liberalization in agriculture. We expected that the isolation of the main determinants of institutional change would be the outcome of comparing theoretical and empirical studies from the countries. Today we know that this concept was overambitious. To undertake such comparison first requires a detailed understanding of the political constraints of reform in each country. After this task is completed, one may then analyze the results of policy implementation on a comparable data set. But seven years after its beginning, transition was too fresh and too complex a phenomenon to allow for straightforward empirical and theoretical analysis on a cross-country, cross-institutional development level. Little literature and the absence of reliable data provoked many discussions and in the end demanded field research in order to test and enlarge knowledge and instruments. This paper draws upon the lessons learned from this experience as well as the numerous studies conducted within the KATO-network.

The paper is structured as follows: Section one will introduce institutional analysis by discussing Williamson's "four levels of social analysis" framework. Using his terminology, we will highlight the special features of institutional analysis of the transition process in agriculture and ask how these special features can be tackled, both empirically and theoretically. Sections two and three will try to give answers to these questions. Section two will also, with regard to our empirical studies, discuss the suitability of different empirical designs. Section three will do the same with regard to theories and the utilized assumptions and definitions. Finally, we will address the role of government in institutional change and summarize our findings in order to draw policy recommendations.

## 2 The Analysis of Agricultural Transition - Skipping the 'Test of Time'

The analysis of agricultural transition in CEECs is constrained by the fact that the subjects under investigation do not have long historical records which allow us to reduce the complexity of the research. This phenomenon has been given names like 'jump start,' 'transitional shock,' 'institutional vacuum,' 'break-down' or 'revolution' in literature; and they all refer to the problem that current research cannot plausibly rely on any time series or constant relations between variables which have passed the 'test of time' over the years. Hence, the analysis of institutional change in agricultural transition must take place in a rarely explored research environment. For this, the New Institutional Economics Framework is a promising analytical starting point.

### 2.1 A New Institutional Economics Framework for the Analysis of Social Outcomes

Williamson's four levels of social analysis (2000: 597) delivers a scheme which distinguishes between the different perspectives of social analysis regarding types of institutions, the considered time frame for the analysis of change, and a normative criterion for what is to be economized (see Figure 1).

On each level of institutional analysis Williamson proposes different theories, ranging from social theory, property rights theory, positive political theory, and transaction cost economics to neoclassical and agency theory for the analysis of economic interaction on the level of private ordering and resource allocation. For our purposes, the interesting point of this graph is the time frame and the hypothesized links between formal and informal institutions on all levels.

[Insert Figure 1 about here]

Williamson calls the first level of the analysis ‘social embeddedness’ (L1) which deals with norms, values and customs. Usually, institutional economists do not treat informal institutions as variables in their analysis since changes in norms and customs are supposed to take much longer than in political institutions or organizational structures (Williamson 2000: 596). The informal institutions at L1 are said to be mainly of spontaneous origin, thus – “deliberate choice of a calculative kind is minimally implicated (Williamson 1998: 27).” Within the constraints imposed by the embeddedness level (L1), the ‘formal rules of the game’ develop (L2). They may stem from “evolutionary processes but design opportunities are also posed (Williamson 2000: 598).” This opens up the possibility to purposefully economize transaction costs by shaping the rules of the game in the right way (first order economizing).

On the second level, property rights *govern* the use of resources, and enforcement is entrusted to the government with its bureaus. Even though formal institutions change faster than informal ones, change will take decades or even centuries unless massive disruptions take place. The suggested theoretical frame for analyzing institutions and social outcomes at this level is the Positive Political Theory and the Theory of Property Rights.

In the context of Williamson’s critics of the Property Rights Theory, transaction costs come into play: “The claim (...) that the legal system will eliminate chaos upon defining and enforcing property rights assumes that the definition of enforcement of such rights is easy (costless) (Williamson 2000: 599).” Transaction Cost Economics (TCE) believes it impossible that a legal system can function costlessly and frictionlessly. Consequently, “much of the contract management and dispute settlement action is dealt with directly by the parties (Williamson 2000: 599).”

This allows us to distinguish a third level of social analysis (L3), which in the realm of politics deals with organizations as the perfect match between specific sets of transactions and the appropriate choice of contractual relations. Thus, it again offers the opportunity to economize. Changes at L3 are supposed to occur over a period of one to ten years. Finally, the analysis of the continuous process of resource allocation on the fourth level (L4) is left to Neoclassical Economics in conjunction with Agency Theory.

## 2.2 Categorizing the Problem of Agricultural Transition

Using this scheme allows us to classify institutional change regarding agricultural transition. Transition in CEECs is to be characterized as a simultaneous and rapid change of institutions at all levels of the society. Starting with L1, the change in ideology and values has probably played a pivotal role in bringing about democratization and the demand for decentralized market coordination. Apparently, not only economic objectives but also the pool of mental models (North 1997) shared by the different ethnic groups and generations is undergoing a rapid transition towards a place not yet clearly defined. People experience and affect the emergence of new norms regarding fairness, the division of responsibilities between the individual and the state, the role of competition, national identity, business attitudes, the treatment of history and the like.

Since defining formal rules is usually constrained by these norms and values, an ‘L1–vacuum’ obscures the incentives and objectives of those in charge of designing reforms on L2. Not surprisingly, the CEECs struggle with unstable governments that experience problems in reform implementation and a lack of credibility in the new rules. Swinnen (1994, 1996) describes the political economy dilemma of choosing and implementing agricultural reform policies in CEECs as balancing the need for ‘doing historical justice’ regarding ethnic conflicts and the need to satisfy the conservative orientation of the rural population which often forms a considerable percentage of the electorate. To some extent, the disappointing results of agricultural privatization and land reform in many countries demonstrate the problematic links between the first two levels of social analysis in Williamson’s structure (Swinnen 1994, 1996; Hanisch and Boevsky 1999).

Aligning governance structures with transactions is what actors are supposed to do on L3. Producers must decide about how to optimally safeguard specific investments, how to protect their intellectual and

physical capital, how to contract for reliable factor quality and supply and the like. The transitional economy suffers from poor market development and little organizational experience. In this situation, bounded rationality and asymmetric information are supposed to play a much larger role than established market economies (Hobbs, Kerr and Gaisford 1997). Contracting of labor and land lease, transactions on product, service and credit markets all incur interactions which are usually embedded in traditional systems of property rights and are complemented by the socially accepted customs and norms of the population. Trustworthiness and reputation, both of which are crucial guideposts for contractual man in agriculture, are built on long-term relations and clear expectations on the role of the state in enforcement. Without such a 'test of time', choices that occur during economic transition, for instance choosing between joining a co-operative, founding a leasing company or family firm, or even between subsistence orientation, sharecropping and fixed rent arrangements, may be best described as experiments rather than the outcome of farsighted economic calculus.

The fourth level of social analysis refers to the process of allocating resources. The analysis of rural unemployment, wages, and factor prices and the impact on the actors' incentives to produce for the market are subjects relevant at L4. Difficulties occur when price effects should be isolated for various state-interventions like trade or land restitution policies, the privatization of agricultural assets and the politically induced reorganization of agricultural farms. Marginal conditions change with these massive interventions and with them the incentives for the producers, managers and landlords. Additionally, the distributional effects from dividing the enormous cost of transitional changes among actors will impact both the way informal institutions emerge, and the elbow room for choosing organizations and policies.

Although designed for a more general treatment of institutional change, Williamson's four level scheme has proved to be a useful tool for structuring and characterizing the specific case of agricultural transition. As we have seen, not only the different levels but also the understanding of the links and feedbacks between the levels is of special importance if one wants to analyze the transition process.<sup>1</sup> These findings have consequences for the design, the instrumentation and the objectives of empirical and theoretical analyses which will be exemplified in the following.

### **3 Lessons from the Study of Agricultural Transition**

#### **3.1 The KATO Research Project**

The KATO- project explored various facets of agricultural transition in order to create a comprehensive understanding of the process of agricultural transition. Agricultural transition in three quite different countries, Poland, Bulgaria and the Czech Republic was the general subject of our research. With regard to the previously discussed levels, the KATO- project conducted three types of studies:

1. *Analyses which focus on the efficiency analysis of different determinants of resource allocation at L4:* The growth-effects of applying different reform policies (Pavel 2000), the impact of competition in the respective markets on the technical efficiency of different organizational types (Curtiss 2000), the efficiency of investment promotion (Czerwinska 2000) and the technical efficiency of farm organizations (Kaneva 2000) were the subject of investigation.
2. *Analyses which focused on the explanation of governance structures at L3:* Transaction cost argumentation was employed in order to explain contracting forms in the hog supply chain (Boger 2001) and restructuring/downsizing of post-socialist agricultural firms (Brem 2000).
3. *Analyses which focused on the explanation of the process of property rights formation at L2:* For the analysis of the process of property rights formation in agricultural land and non-land assets, researchers complemented a set of Public Choice and Transaction Cost Hypotheses with those of the Theories of Social Conflict and Collective Action in order to compare the explanatory power of the different hypotheses (Hanisch 2001; Milczarek 2001; Schlüter 2001).

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<sup>1</sup> Williamson (2000: 596) remarks that the New Institutional Economics (NIE) often neglects the links between different levels of social analysis: "Although in the fullness of time, the system is fully interconnected, I mainly neglect these feedbacks. The NIE has been concerned principally with levels 2 and 3."

An international team of researchers from Germany, Poland, the Czech Republic and Bulgaria contributed to the network. Although the studies widely differ in terms of their respective research questions, empirical methodology and the used theoretical concepts, it has proved to be illuminating to assimilate the different study designs into the proposed scheme in order to compare the different kinds of research questions which the study designs set out to answer (see Figure 2).

Researchers from the ‘allocation group’ were concerned with measuring the *effects* of different factors on the efficiency of resource allocation (Pavel 2001; Curtis 2001; Kaneva 2001; Johnova 2000; Zillmer 2001). These studies provide answers to the questions of how a transition-specific institutional environment (L2) and different degrees of competition on important agricultural markets affect resource allocation (L4). For instance, Pavel (2001) examined the effects of liberalization policies in a dysfunctional institutional environment characterized by rent seeking and corruption. Curtiss (2001) explored the *effects* of different market regulations on the technical efficiency of farms while distinguishing between size and type of agricultural farms. Czerwinska (2001) studied the *effects* of transitional credit support programs on the investment behavior of farms in Poland.

Producers’ marketing behavior within a rapidly emerging institutional setting of quality markets was the subject of Boger’s (2001) investigation (L3). As a member of the ‘governance group’, she analyzed causes of contractual choice given quality-segmented markets and still-evolving grading systems using TCE. Brem (2001) analyzed organizational choices in the process of restructuring Czech agriculture. A set of transaction cost hypotheses regarding the speed and the different organizational alternatives in the pace of downsizing agricultural collectives were expounded against empirical observations from the regions of North- and South Bohemia (L3).

Finally, there were three studies dealing with the formation of property rights in land and agricultural assets in Bulgaria, Poland and The Czech Republic. The ‘property-rights group’ tried to answer the question of what factors in the pace of reforms determine the formulation of property rights at L2, and how institutions become socially-accepted rights of action in the process of implementation and individual coordination at L3 and L4, respectively (Hanisch 2001; Milczarek 2001; Schlüter 2001). The political process of choosing between alternative forms of asset privatization and land reform measures were analyzed with the help of Public Choice and Positive Political Theory approaches. The identification of various actor constellations on different levels of social analysis allowed to link and analyze the decision-making processes responsible for the formation of economic rights of action.

### **3.2 The Empirical Analysis of Agricultural Transition**

KATO researchers used different data sources (official national statistics, survey data and qualitative information gained from case studies) and applied varying empirical approaches. The next section will address three types of empirical problems regarding the availability of data, the application of the survey approach, and the conducting of case studies.

#### *3.2.1 The Data Problem*

Particularly at the beginning of transition, the official statistical information was weak and not very trustworthy in the investigated countries. Complete sets of national statistics were not available. But this was only part of the problem. Information about the issue of institutional development is poor even in the well-kept national statistics of the Western world. The way out is to either take data available and see how far one can get, or collect data by means of surveys and case studies. Both strategies were employed in the KATO project.

Pavel (2001) and Curtiss (2001) used national statistics and official data sources from Bulgaria and the Czech Republic, respectively, for their analyses. The Computable General Equilibrium model (CGE) of Pavel is based on a social accounting matrix from 1994. Curtiss’ data base stems from a governmental survey and contains panel data on farm accounts from the years 1996 to 1998. All other projects decided to generate primary data, using different combinations of survey and cases study approaches. In the year 1999, the main data set was created by surveys conducted in up to three different regions of each country. A two-stage sample-technique was applied. In the first stage, villages were chosen by stratification; in the second stage, agricultural enterprises and households were selected randomly. By means of standardized questionnaires, information was gathered about the history of the enterprises, their internal organization and decision making structures, about production structures and factor use, marketing behavior, par-

icipation in the land, labor and capital markets, financial results and about the managers' perceptions of the future. The main limitation of such surveying was the difficulty in getting reliable quantitative information about the dynamic farm development over the entire transformation period. For instance, managers, organizational structures and the production structure of the farms had often changed several times within a few years. Assumptions and estimations had to be made in order to compensate for missing information. This afforded the researchers to complete their informational data base with informal expert interviews and case studies. Depending on the types of research questions, different data collection and processing instruments were chosen.

### 3.2.2 *Matching Research Interest with Empirical Instrumentation*

The 'allocation group' was mainly interested in the analysis of policy measures and the efficiency of resource allocation. Using national statistics and carrying out quantitative surveys proved to be adequate for this research purpose even though the typically processual character of transition and the links between the different levels of social analysis could not be explicitly recognized in these approaches.

The 'governance group' tried to answer the question of how actors manage transactions within the available governance structures. Boger (2001) specified the observed hog transactions in different governance structures using a static and Survey-based approach. An insightful interpretation of the data collected afforded to add case study experience and qualitative interviews with actors in the hog supply chain.

Brem (2001) tried to explain the speed and direction in which Czech farms restructure posing hypotheses about organizational change. This required data collection over a longer time period, which could only be guaranteed by additional case studies taken from the same regions in which he gathered quantitative data for testing his models.

[Insert Figure 2 about here]

The 'property-rights group' was mainly interested in the process of how formal property rights become economic rights of action. Since the links between the levels and the feedbacks were of major importance, information was collected in case studies in which key actors like politicians, advisors, researchers, restituent, farm managers and others were interviewed. Only by picturing a complete scenario of formal and informal institutions, could it be explained how privatization laws emerged and influenced the levels of governance and resource allocation.

From the collection and analysis of primary data, we gained the experience that quantitative measures could be usefully applied to questions in which certain stages of the transition process shall be explained. However, institutional change in the transition process could be addressed solely by means of carefully conducted case studies and informal interview techniques. In particular, the role of history, certain informal institutions, and different actor constellations proved to be of major importance for the process of institutional change in transition. This leads to two kinds of empirical lessons which we address in the next section.

### 3.2.3 *The Complexity Problem – Causes, Effects and Feedbacks*

The first group of studies analyzed the *effects* of transitional institutional change on resource allocation. Thus, the research interest widely followed a uni-dimensional causal chain known from neoclassical analysis (see Figure 2). Questions such as how price liberalization affects growth in a sector which is characterized by rent-seeking and corruption were addressed (Pavel 2001). Others asked how state regulations affect the efficiency of different farm organizations in a transforming agricultural sector (e.g. Curtiss 2001). By neglecting the interaction between the links, and taking into account the role of informal institutions, the empirical analysis can produce results by means of modeling and statistical methods.

The 'governance-group' focussed on causes of the emergence of organizational forms with respect to the specific institutional environment. In Boger's study, the characteristics of hog transactions in Poland as determinants of contractual and marketing channel choice was analyzed in the year 1998, given a certain institutional environment in which interactions between L2 and L3 were kept exogenous to her model. Nevertheless, the qualitative study, showed that quality-specific investments could not always be safeguarded in an inappropriate institutional framework (Boger 2001a). The combination of a quantitative static approach with a qualitative dynamic approach allowed to concretize statements on institutional change.

Moreover, Brem focused on the dynamic perspective by developing transaction cost hypotheses about the direction and dynamics of the farm restructuring process in the pace of Czech transition. Mentioning the problem of collecting data about organizational change, he added three case studies to his set of data in order to make his model assumptions plausible. As a result he explicitly emphasized the role of informal relations between collective farm members as a determinant of organizational change.

Focusing either on a *causes* or an *effects* perspective contributes to the easing of the problems associated with empirically analyzing institutional change in transitional agriculture. Following unidimensional causal chains will often allow to get along with information from national statistics and survey data gathered on a firm or household level. This methodology is useful for analyzing the effects of single policy measures on the level of resource allocation or contractual choice regarding those transactions which can be precisely described in a certain institutional environment.

However, the intrinsic dynamics of institutional change on all levels of social analysis requires a close look at the circular relations between causes and effects and the way they affect new institutional outcomes. For that, a qualitative case-study approach targeting the empirical analysis of processes and actor constellations is necessary, and was chosen from the 'property-rights group.' Hanisch (2001), Milczarek (2001) and Schlüter (2001) analyzed the processes of land privatization and property rights development within actor and process-oriented case studies including the feedbacks and processes between different levels of social analysis, a task which demands intimate knowledge about social relations. Furthermore, the actor-oriented interview approach helped to gain useful insights into the political process of formulating privatization laws (L1). Simultaneously, the process of how these reform laws affect actors and turn into new economic rights of action on the level of private ordering was analyzed, treating changing policies as well as the norms and values of the involved actors as endogenous.

### **3.3 Theoretical Lessons from Analyzing Agricultural Transition**

Which theoretical lessons can be drawn from the analysis of institutional change in transition? As mentioned previously, Williamson (2000) suggested investigation of the emergence and change of informal institutions within a Social Theory Framework; changes at the level of political institutions with approaches from Positive Political Theory and the Theory of Property Rights; the evolution of contracts and organizations with the Transaction Cost Approach; and changes in prices and incentives within Neoclassical Economics and Principal Agent Theory. It has been shown in the KATO project that the typical features of institutional change in agricultural transition may sometimes afford to deviate from this proposal. The following section will discuss the different project parts with regard to the used theory framework and the strength and weaknesses of these theories in explaining transitional phenomena. (1) Neoclassical Economics, (2) Transaction Cost Economics and (3) Property Rights and Public Choice Theory, complemented by distributive bargaining hypotheses, will be treated.

#### *3.3.1 Analyzing Allocative Effects: Neoclassical Economics*

The basic assumption of Neoclassical Economics is profit and utility maximizing behavior of perfectly rational agents in a competitive, frictionless market environment. As such, one might think that Neoclassical Economics can contribute little to an understanding of transition, because it assumes rather than explains market developments and behavioral changes (Murell 1991). However, if we follow Williamson's proposal (2000) and use Neoclassical Economics, among others, to analyze allocative *effects* of institutional changes in the transition period (L4), it may contribute to a better understanding of institutional change as a whole. For instance, models can be complemented by more realistic assumptions borrowed from the New Institutional Economics Framework. Interpretation of the results of such neoclassical analysis may well include arguments known from Transaction Cost or Principal Agent literature. This precisely describes the way in which neoclassical economics was operationalized in the KATO project.

Pavel (2001) investigated the effects of price liberalization on economic growth in Bulgaria by using a dynamic Computable General Equilibrium (CGE) model. Pavel consequently adapted his model to the conditions which characterize the Bulgarian case. Like in many other transition and developing countries, rent seeking and corruption is reported to hamper economic growth in Bulgaria. Before Pavel's study, empirical tests were grounded on cross-country analyses. Pavel took a different approach. He modeled price liberalization scenarios in Bulgaria in two different institutional environments; one in which 'strong property rights' avoid market distortions and one in which they do not. Having modified



his CGE model, the results provided a strong argument for the ‘bad-governance-hampers-growth’ hypothesis. As long as rent seeking prevailed, standard liberalization policies even had negative impacts on economic growth and induced hardly a change in welfare.

Zillmer (2001) and Czerwinska (2001) applied Neoclassical Household Theory in order to examine off-farm employment and investment decisions by rural households in Poland, which is a common enough way of modeling these decisions. However, in order to capture the specific features of transition, Zillmer took various market imperfections into account, typical for the Polish rural labor market during transition. This allowed her to quantify how far personal immobility and labor search costs play a role in the process of labor allocation in agriculture. Czerwinska (2001) applied a neoclassical model in order to find out how investment support policies affect the behavior of family farms during transition. Her theoretical considerations were supplemented by agency theory and transaction cost reflections regarding the market for agricultural credit. Czerwinska (2001) concludes that in transition, investment promotion programs can significantly help to overcome deficiencies caused by high transaction costs on transitional capital markets. In the interpretation of the results of her analysis she emphasizes the transaction-cost reducing role of investment support programs in the process of Polish agricultural transition.

Finally, Curtiss (2001) and Kaneva (2001) examined the effects of organizational choice between different farm organizations (family farms, co-operatives, companies) on the technical efficiency of production by means of Stochastic Frontier Analysis (SFA) and Data Envelopment Analysis (DEA). These methods of efficiency analysis are based on the neoclassical theory of the firm (Coelli 1989). However, neoclassical theory offers no hypotheses about the effects of different organizational forms on technical efficiency. Thus, the theoretical considerations were based on agency theory and intra-firm transaction cost comparisons assuming higher technical efficiency of family farms and lower technical efficiency of co-operative farms (Schmitt 1993; Allen and Lueck 1998; Beckmann 2000). However, as Allen and Lueck (1998) and others have pointed out, these internal transaction cost advantages heavily depend of the production type. Kaneva (2001) found the average farm in Bulgaria to be rather inefficient regardless of the organizational type, with family farms showing only a slightly higher performance than other organizations. Compared to Bulgaria, the efficiency level of Czech farms was much higher, as the study of Curtiss shows. In the Czech Republic, family farms turned out to be relatively more efficient only in segments with labor and capital intensive productions. Where production was characterized by relatively low labor and capital inputs, producer co-operatives performed better than family or corporate farms.

In summary, the ‘allocation group’ was able to show the allocative outcomes under the conditions of the typical transitional phenomena. These analyses yield good results by systematically taking into account market imperfections and transaction costs on markets and within organizations even when using static uni-dimensional approaches. This is true for neoclassical policy analyses as well as for the analysis of technical efficiency in firm to firm comparisons.

### *3.3.2 Transaction Costs: The Driving Forces of Market Development*

Transaction Cost Economists analyze economic behavior at a different level of the economy than do neoclassical analysts. Not the process of matching quantities and prices, but the process of matching specific transactions with the respective governance structures or bundles of contracts is subject to the analysis. In order to economize on transaction costs, boundedly rational actors have the choice between exchanging goods or services at the market place, within firm hierarchies or in governance structures which are between both extremes of co-ordination (hybrids). As such, organization of a transaction at any given point of time may be explained as the result of the actor’s search for optimal exchange in the presence of a situation-specific pattern of transaction costs.

This TCE standard approach was applied by Boger (2001a,b) in order to examine the determinants of the market organization in the Polish hog supply chain. The study aimed at identifying and explaining the different marketing arrangements by investigating the relationships between asset specific investments, contracts, quality, prices, and the marketing channels used for hog transactions. The empirical analysis of the survey data using multivariate techniques (factor and cluster analysis) and multinomial logit models could show how the different hog marketing arrangements are organized in markets which undergo a segmentation into different quality segments. We observed marketing arrangements that were not entirely expected from theoretical considerations. The results above all indicate that quality-based pricing is not clearly established on the hog market, instead higher prices tend to coincide with stronger bargaining

power, and producers are not always able to secure their quality-specific investments as predicted by TCE. TCE contributes substantially to the understanding of evolving agricultural markets in transition; however, one major result discloses that not all of the observed marketing arrangements had been expected, because pure TCE was developed for analyzing transactions in a matured, given institutional framework. The institutional setting for obtaining a reward for quality production can be subject to a high degree of uncertainty in evolving markets, which may afford further institutional change to avoid the risks of contractual hazards.

Brem (2001) examined the re-organization of state and collective farms in the Czech Republic using a transaction cost approach. In order to explain organizational choice in the pace of the restructuring of post socialist agricultural firms, he extended the traditional comparative static approach by drawing transaction cost assumptions about the cost of organizational change. This allowed him to distinguish between two different types of transaction costs, the transaction cost of running an existing agricultural firm inherited from the socialist past, and the transaction cost of restructuring and downsizing such a firm. The former cost component depended on an intra-firm measurement problem (e.g. labor), while the latter component depended on asset specificity problems in downsizing. An explanation for the process of downsizing and restructuring in the agricultural sector of the Czech Republic evolves from drawing models which consequently incorporate his assumptions. As a result, Brem shows how the history of the farm affects the choice of the governance structure in the pace of restructuring. In the cost-benefit calculus between keeping highly specific assets in the existing organization of production or re-deploying them in other forms of organization, the high transaction cost of change often leads to an avoidance of restructuring.

The lesson to be learned from the theoretical analysis is that in cases where contractual choice, with regard to clearly defined transactions with few institutional alternatives and foreseeable pay-offs is concerned (Boger 2001a,b), it seems plausible to abstract from the influence of other levels of institutional development in order to explain phenomena like organizational or contract choice in agricultural transition. Results explain the state of the art in the development of governance structures at a certain stage of market evolution, and help to identify the requirements for further development. The use of the TCE for the analysis of a dynamic process, as is the case of Brem's analysis of the Czech restructuring process, is a challenging step into a new area of transaction cost analysis. The dynamic perspective of TCE is still underdeveloped. Both studies conclude that using basic theoretical tools definitely supports the development of a structured framework for the analysis; however, the evolutionary character of transition processes requires further specification of models and instrumentation.

### 3.3.3 *The Theory of Agricultural Property Rights*

The 'property-rights group' dealt with the analysis of agricultural property reforms in Bulgaria (Hanisch 2001), the Czech Republic (Schlüter 2001), and Poland (Milczarek 2001). The theoretical basis for the analysis and the way it was extended was similar in the three studies. The aim was clearly positive and directed towards extending and improving the theoretical understanding of agricultural property reform.

#### *A Theory Puzzle*

The economics of legal relationships are a prominent area of research resulting from the liaison between law and economics in the early 1960's. The cornerstone of this research area may be characterized by the question of how rights re-emerge and come to command respect (Buchanan 1975: 77). Neoclassical analysis treats the political process exogenously and does not tackle the relation between the allocation of rights and the allocation of resources (Pejovich 1975: 38). Demsetz (1967: 347-359) showed that the development of property rights in land among American Indians was endogenously determined; that is, it took place in response to the desire of the interacting persons for more utility. He concluded that where externalities in exchange are unavoidable, property rights must be defined and enforced in order to internalize externalities when the gains of internalization become larger than the cost of internalization (Demsetz 1967: 360). This "naive" view of the process of property rights creation (Eggertson 1990: 23) was criticized because it does not allow for the acknowledgement of inefficient social outcomes (Olson 2000: 58), and because it reduces the role of the state solely to the arbitration of private disputes (Williamson 2000: 598). Libecap (1993: 31) proposes to extend the Theory of Property Rights with a positive analysis of the political process.

Public Choice Theory (Buchanan 1975; Downs 1957) and Olson's Theory of Collective Action (1965) are theoretical elements which allow for a rational choice analysis of the political process. Authors like Dixit (1996: 125) or Williamson (2000: 601-602) translated TCE into politics: at first sight inefficient political outcomes must be reassessed with regard to the transaction cost constraints in the political process. Unless a better policy can be identified *and* implemented, the one in place is to be called efficient. North (1990) is skeptical about the general belief in the efficiency of the political process. He posits that institutions can only serve efficiently if they arise in a market-like environment. He stresses the role of learning processes for the evolution of institutions. In situations in which competition is not in place, learning will take much longer and the continuous process of re-bargaining for property rights will often not yield efficient results (North 1990: 95).

This is the starting point of Knight's Theory of Social Conflict (1992). He describes property rights as the outcome of distributive conflict between self-interested individuals with often asymmetric resource endowments and bargaining strength. His focus lies on the emergence and change of informal rules like ideologies and customs because he is convinced that it is the informal rules and values which form the basis for social acceptance, and thereby legitimization of economic rights. As a consequence, in such explanations, efficient outcomes are the exception rather than the rule in the process of property rights formation.

### *Putting the pieces together*

Figure 3 delivers an actor-centered 'model of thought' depicting the process of property rights formation within the pace of transition. The illustration shows a rational choice model which focuses on the analysis of *The Choices and Actors in Charge* between individual and political decisions. To the left of each actor there is the *Pool of Alternatives* to consider while analyzing decisions. *Results* from choices on the political level (A1) turn into restrictions (slashed arrows) on the choice of alternatives on the subsequent levels of decision making, as appears on the level of reform implementation (A2) and the level of private ordering (A3). Here governance structures arise and the perceived income distribution feeds back to the constellation of political actors (policy cycle). The slashed arrows point in two directions. This means that decisions on a higher level are constrained by the respective political and implementational costs which consequently arise and which allocate a price to each political and administrative decision. This political economy model allows us to position different theoretical lenses regarding the mechanisms of institutions. The advantage of linking hypotheses from different theories is that it allows to consider different mechanisms of institutional change in one and the same process, thus the links between different levels of social interplay and its dynamics can be the subject of hypothesizing.

A1: Political decisions regarding land reform policy and the privatization of agricultural assets are explained in the context of the political influence of the rural electorate, and the specific features of the discussed choice alternatives (reform packages). Public Choice hypotheses about the actors' objectives concentrate on the aspect of defending political power, or following certain party ideologies (Swinnen 1997). The efficiency of reform policy has to be judged with respect to 'The Pool of Alternatives' and the cost of carrying through and implementing them.

A2: Bureaucratic decisions regarding the interpretation of formal rights and reform policy must be explained in light of the cost of reform implementation and the related principal agent problems between government and administration. Constraints on the elbow room of actors arise from what is budgeted or written down as laws, and from the available instruments to control bureaucrats in business. Transaction Cost and Principal Agent hypotheses concentrate on the objectives and elbow room of certain actors, the incentives to carry out or boycott implementation, or those who extract money through corruption. A3: Property Reform asks local actors to decide on two general questions: first, what to do with formal land rights? Second, what to do with vouchers or physical assets? Thus, new formal property rights need to be exchanged to become rights of action (Barzel 1989: 2). Decisions, be it a single contract on land rent or the buildup of whole agricultural firms, make up part of the process of forming new property rights. Income is generated, distributed and protected in this process and the value of each actors' share of income from exchange and coordination gives notice about the nature of the involved property right. Different assumptions about the nature of exchange have been posed, and will be explored below

*Efficiency:* Transaction Cost Theory stimulates the Theory of the Agricultural Contract and the Theory of Property Rights (Cheung 1969; Hayami and Otsuka 1993): Governance structures are supposed to be

voluntary agreements between boundedly rational actors. The outcome of contracting is believed to be an efficient result with regard to the specific transaction cost involved in each specific problem of agricultural exchange. In transition the following mechanism may be assumed: as soon as an initial structure of *formal property rights* gets enacted, rational actors bargain with each other and leave no money on the table until a mutually advantageous definition of *effective rights* to assets and land will be found. The efficiency of social outcomes must be assessed with special emphasis on the attributes of agricultural goods, inputs and services, and the institutional environment in place. An explanation for, at first glance, inefficient outcomes of transitional contracting may arise from the identification of transaction cost constraints on the actors. In transition, typical outcomes like sharecropping, producer co-operatives, subsistence farming, and regional monopolies may be explained as rational actors' responses to the malfunctioning of credit, risk, or manager markets, or to the specificity of agricultural assets.

*Distributional Conflict:* Institutional economists do not usually question the concept of efficiency as the backbone of the explanation of social outcomes. However, traditionally there is another strand of argumentation which is based on a model of social interaction which allows for actor differences to play a role in shaping outcomes (Knight 1992). Agricultural property reform often creates an exchange situation which is constrained by considerable transaction costs and by which formal rights to resources are distributed. In such a situation, the Distributive Bargaining Theory assumes that in the bargaining for economic rights, (1) market competition or rivalry between actors might not suffice to even out differentials in bargaining strength, (2) actors with different endowments of bargaining-relevant resources face distributive conflicts and seek strategic advantage (Schelling 1960: 18).

The processes of initial issuing of formal rights down to the moment of collective acceptance of new economic rights of action involve informal rules like ideology, reputation and leadership to organize collective action. Therefore, in rural societies, action rights may reflect rural authority relations, manipulation via asymmetric information, non-decision making, temporal vulnerability of producers, the threat of retaliation, or even naked force. The exchange of new agricultural property may be characterized by little competition and distributive conflicts about key resources. Actors may be distinguishable in terms of the resources they can put into play.

In transition, typical outcomes like sharecropping, producer co-operatives, subsistence farming, and regional monopolies may be explained as protectionist efforts of otherwise vulnerable actors, the successful capture attempts of single actors; or by some actor constellations holding key attributes for agricultural production or marketing.

#### *Towards a comprehensive understanding of agricultural property reform in transition*

A common result of the studies is that the formal property rights which were formulated to start the reform process had little more to offer than to give some orientation for the bureaucratic process of asset privatization and land titling. As a matter of fact, the laws and regulations designed to institute agricultural transition did little else but pass on to rural actors the immense transaction costs associated with defining and protecting these new rights. The political conflict over land reform and asset privatization laws was strongest in Bulgaria, where each time the government changed hands, reform policies were altered (Hanisch and Boevsky 1999). However, in all of the countries the provisions of reform laws had little to do with day-to-day practices in the villages. Schlüter (2001) found that while the Czech agricultural privatization scheme formally benefited restitutes, former agricultural managers clearly benefited from controlling the privatization process in the villages. Hanisch (2001) and Milczarek (2001) made similar observations in Bulgaria and Poland. In Bulgaria, Hanisch observed that those intending to found a family farm had practically no access to privatized machines, even in cases in which they had bought considerable amounts of shares. His empirical results show that those voucher holders who did not intend to join a co-operative were systematically discriminated against in the privatization process. This discrimination was underpinned with ideological reasoning stimulated by the lobbying activities of rural leaders like managers and village mayors. Going private equaled "stealing from the co-operative" and was not socially acceptable at that time.

[Insert Figure 3 about here]

Those and other examples from the country studies indicate the importance of analyzing property reform in transition as a process. A distinction must be drawn between formal and effective property rights in order to capture the dynamics and links between politics, implementation and private orderings, and the

role of informal institutions<sup>2</sup>. Regarding the analysis of transactions in situations where formal laws are obscured and subject to interpretation, efficiency and transaction cost hypotheses are often not enough to create a comprehensive understanding for the evolution of rights. In the case studies, the effect of certain actor constellations on the level of private ordering, ideology, and the efficacy of competition on input markets as a means for providing choice alternatives proved to be of major importance for explaining decisions regarding governance, land and asset allocation, and the nature of the involved economic rights of action. Social acceptance as a precondition for the institutionalization of rights demands special analytical emphasis for the role of collective action and the position of rural leaders.

### 3.4 Policy Lessons from Analyzing Agricultural Transition

The fundamental problem in giving policy advice is that as soon as economists propose measures which put costs on economic actors, politicians will have to label 'efficiency' and 'growth' with the names of those to pay for these achievements. One way out is to assume away distributive effects and how they may hamper policy design and implementation. In this case, the political process remains exogenous and efficiency or economic growth are 'objective' criteria for ranking different policies. The other option is to resort to the positive analysis of the determinants of political and economic decision making. This option perceives the political process as endogenous in the analysis and as a consequence, normative statements about how to get the institutions, the governance structures, or the marginal conditions 'right' are much more difficult to make.

KATO studies can be categorized into the previously described continuum between studies which give straightforward policy advice on the basis of efficiency or growth criteria, and studies which investigated the political economy of agricultural reforms without normative research interest. Both the 'allocation group' and the 'governance group' take policies as exogenous and identify institutional impediments for improving allocation efficiency or for lowering transaction costs. Hence, policy recommendations turn the observed relations between model variables into "target-instrument"-functions, implicitly assuming that politicians are able to control the respective instruments. This allocates a strong role to government in institutional change and implicitly assumes a "helping hand" model of the state (Shleifer and Vishny 1998: 17). For instance in Bulgaria, rent seeking is observed to be a major impediment of agricultural growth. Hence, Pavel's recommendations focus on the alleviation of rent-seeking and corruption incentives in the agrifood chain and the respective bureaucracy (2001). By modeling different policy scenarios, he concludes that Bulgaria requires a deeper reform than just canceling tax and tariff distortion in order to increase welfare and efficiency. Policies should rather focus on anti-corruption measures, the establishment of NGOs for enhancing social capital and the strengthening of legal enforcement.

Poland's economy, much more advanced in this respect, also lacks some of the necessary institutions to make markets work. The example of the Polish hog market shows that lack of a standardized grading systems creates high uncertainty regarding the judgement of product quality (Boger 2001b). Hence, the role of the state in supporting market development must be redefined towards a more active involvement in the mechanism of markets. If private governance fails to provide security for specific investments and contractual arrangements, public governance through regulation may be a more efficient solution to protect property rights. For the Polish hog market, the obligatory introduction and monitoring of standardised grading systems, conceivably combined with structural support for their implementation, may reduce transaction costs and increase the sector's welfare more effectively than using price regulation in order to avoid the adverse effects of transition. As Czerwinska showed with her example of the effects of the capital market constraints on the investment behavior of Polish farmers, state intervention in the capital market through investment promotion schemes proved to be an adequate tool in cases where transaction costs on capital markets impede investment (Czerwinska 2001).

The 'property-rights group' regarded policy as endogenous. Expectably no policy advice is extracted from the works of Schlüter (2001) and Milczarek (2001). Hanisch (2001) argues with Eggertson (1997: 71-72) who claims that decision makers on all levels of institutional change in transition suffer from in-

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<sup>2</sup> Barzel draws a clear distinction between legal rights and economic rights. "Legal rights as a rule enhance economic rights, but the former are neither necessary nor sufficient for the existence of the latter." Each actor's possibilities for rights protection, other people's capture attempts and government's efforts towards the protection of individual property rights have to be taken into consideration (Barzel 1989: 2).

complete information and incomplete models of how the politico-economic system works. This gives room for improving decision makers information and models by means of process-oriented positive analyses. Hanisch's advice is directed towards different actor groups and aims at improving the understanding of the property reform process. Pointing at machine distribution to be the key conflict of property reform in Bulgaria, he claims that if policy makers intend to strengthen individual property rights in agricultural land they must avoid asset privatization and credit programs which solely favor large scale farms. In this context he repeatedly explicates the role of social acceptance (fairness) for the evolution of property rights. Those politicians in Bulgaria who do not favor strong property rights in land and assets must understand the spreading of subsistence orientation as the, often, only means to protect the relatively small rents from new agricultural ownership against stronger actors' capture attempts. The fact that Bulgarian politicians often treat the massive development of the subsistence sector in Bulgarian agriculture solely as a problem of missing land consolidation policy is, in the eyes of Hanisch, a misconception and delivers some evidence for the previously hypothesized need to improve decision makers' mental models. Being rather skeptical about the incentives and capabilities of the political actors in Bulgaria, he proposes that those who have an incentive to improve the situation in the agricultural sector avoid strong political measures and instead advocate and support self-help initiatives like, for example, rural credit unions and water and service co-operatives. This kind of advice allocates a relatively weak role to government in institutional change and considers that political action may be constrained by political instability and conflict.

#### **4 Conclusions**

This paper discussed the design and the findings of different studies of the KATO research network along the lines of an NIE Framework. The variety of research conceptions allowed us to explore the strengths and weaknesses of each study's design for answering questions on different levels of the analysis of institutional change in agricultural transition. Implications were discussed under three headings. (1) The empirical design for analyzing rapidly changing and evolving institutions in transition economies; (2) the suitability of different theoretical approaches to penetrate the transition process, and (3) policy recommendations targeting better governance and an improved institutional framework.

The empirical analysis of institutional reform often afforded the application of a mixture of data collection instruments. Extensive surveying of the problem to be investigated proved often to be the only way of testing NIE hypotheses in transition processes. Nevertheless, quantitative data, either collected primarily or used from national statistical offices, only allowed to test hypotheses about causes and effects of institutional choice at a certain moment of agricultural reform. Such kind of data was of little help for assessing the role of actor constellations, historical structures and informal institutions in a dynamic perspective. Because many of the observed institutions were subject to political debate and frequent changes, those interested in the dynamics and interrelations in institutional change had to broaden their views with case studies and qualitative interviews. The political economy process of agricultural property reform was only possible with case studies at a community or village level in combination with interviews with political actors. This experience underlines Alston's findings (1996: 30) that "with the present state of theoretical knowledge about institutions, the case study approach is often the only way to further our knowledge about institutional change." A general lesson from the project is that the development of analytical concepts for transition problems ideally categorize data needs in advance and combine innovatively quantitative and qualitative empirical methods in order to gain promising results.

For an assessment of the theoretical tools for the analysis of agricultural transition it proved to be very useful to discuss the categories proposed in Williamson's four level scheme. Allocation, governance and the political economy of agricultural reform are very different perspectives of institutional change which afforded the application of different theoretical approaches. Our paper discussed the suitability of different approaches with regard to analytical levels and the time frame of the analysis. Neoclassical models were suitable to investigate effects of institutional change on resource allocation. Theoretical elements from the NIE can contribute in two ways to the adaptation of neoclassical models to the special conditions of transition: first, model assumptions may reflect market imperfections due to transaction cost constraints and asymmetric information. Second, NIE argumentation may contribute to the interpretation of the results from neoclassical modeling.

TCE delivers a bundle of refutable hypotheses about market development and institutional choice. Analyses about the status quo in market development and about the determinants of structural change yielded rich insights into the process of agricultural transition. However, the studies showed that the concept is suitable for analyzing the static, rather than the dynamic, dimension of agricultural transition. Transaction cost predictions about the adaptation of organizations still lack precision and may be the subject of further elaboration of the NIE.

The Positive Theory of Property Reform still represents a puzzle of different approaches. For the analysis of agricultural property reform it was useful to develop a comprehensive model of choices, actors and opportunities in order to combine different hypotheses on different levels of social analysis. Such a concept has its clear empirical limitations. However, in order to extend the Theory of Property Rights, it seems to be of importance to make room for more accurate hypotheses about distributive conflicts and informal relations among actors in the process of property rights formation.

The objective "To analyze institutional change in transition," to some extent conflicts with the objective to give policy advice. While an exogenous treatment of political institutions typically ignores the constraints of agricultural reformers, a fully endogenous treatment may reveal that the portfolio of alternative policy choices approaches an empty set (Eggertsson 1997: 71)." NIE's insights are in most cases still too general for guiding transitional policy (Smyth 1998: 361). An important facet in this context seems to be the search for better criteria to allow for ranking different policy alternatives. A good illustration of how far away the NIE still is from guiding transitional policy is given in the following statement from Williamson:

"What I have referred to as the remediableness criterion is intended to rectify this asymmetric state of affairs. This criterion (remediableness) holds that an extant mode of organization (government included) for which no superior feasible alternative can be described and implemented with expected net gains is presumed efficient (...) Finally, grounds for rebutting the efficiency presumption need to be addressed-which brings in politics. Absent rebuttal, the remediableness criterion stands as a reminder of the obvious: it is impossible to do better than one's best" (Williamson 2000: 601-602)."

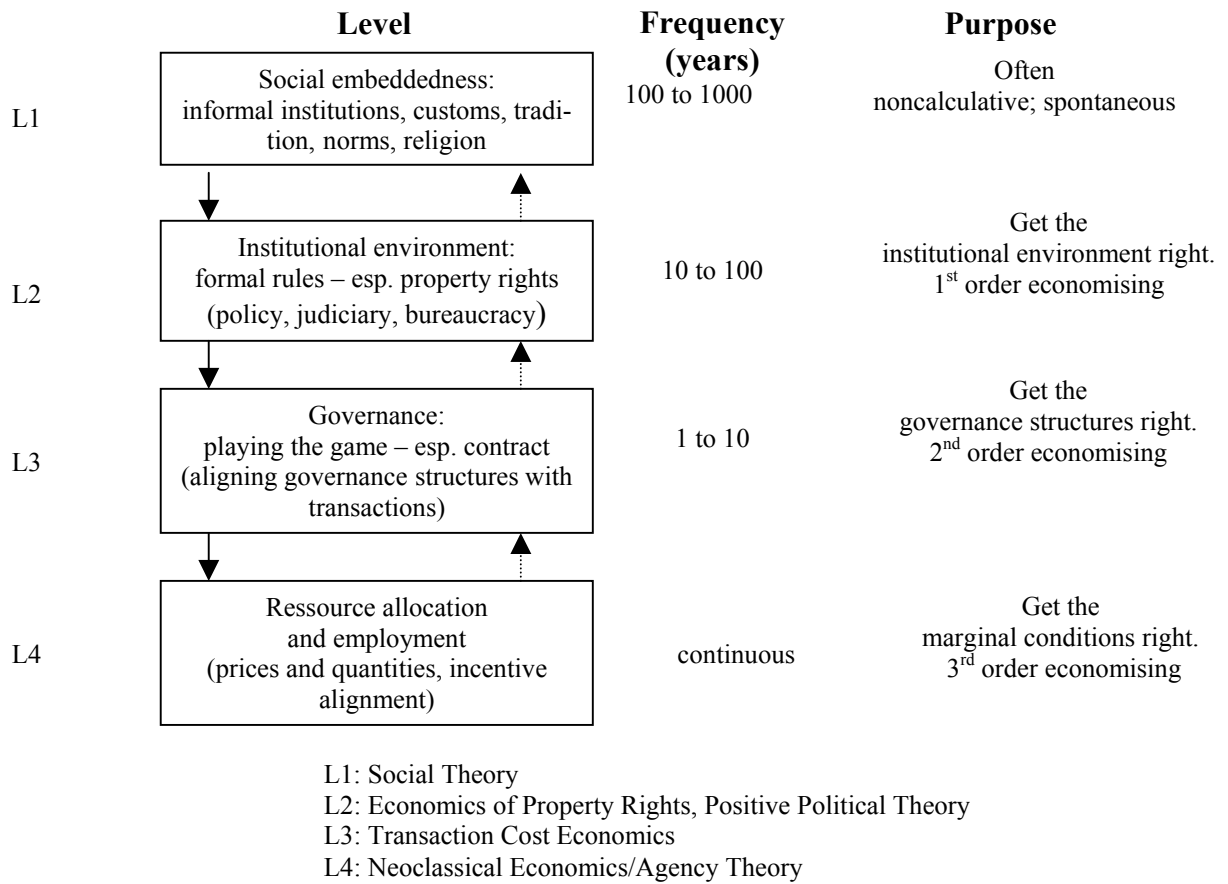
This statement clearly overstrains the capabilities of most research concepts, since it demands a complete ex-ante and ex-post assessment of all possible institutional alternatives with their respective political and implementation costs before changes can be proposed. Thus, a more practical agenda for offering good advice based on an NIE framework is a pressing need for further research. The KATO project, as an interdisciplinary research network that above all targeted the extension of theories towards more comprehensive models, was only a first step in a new promising area of future research.

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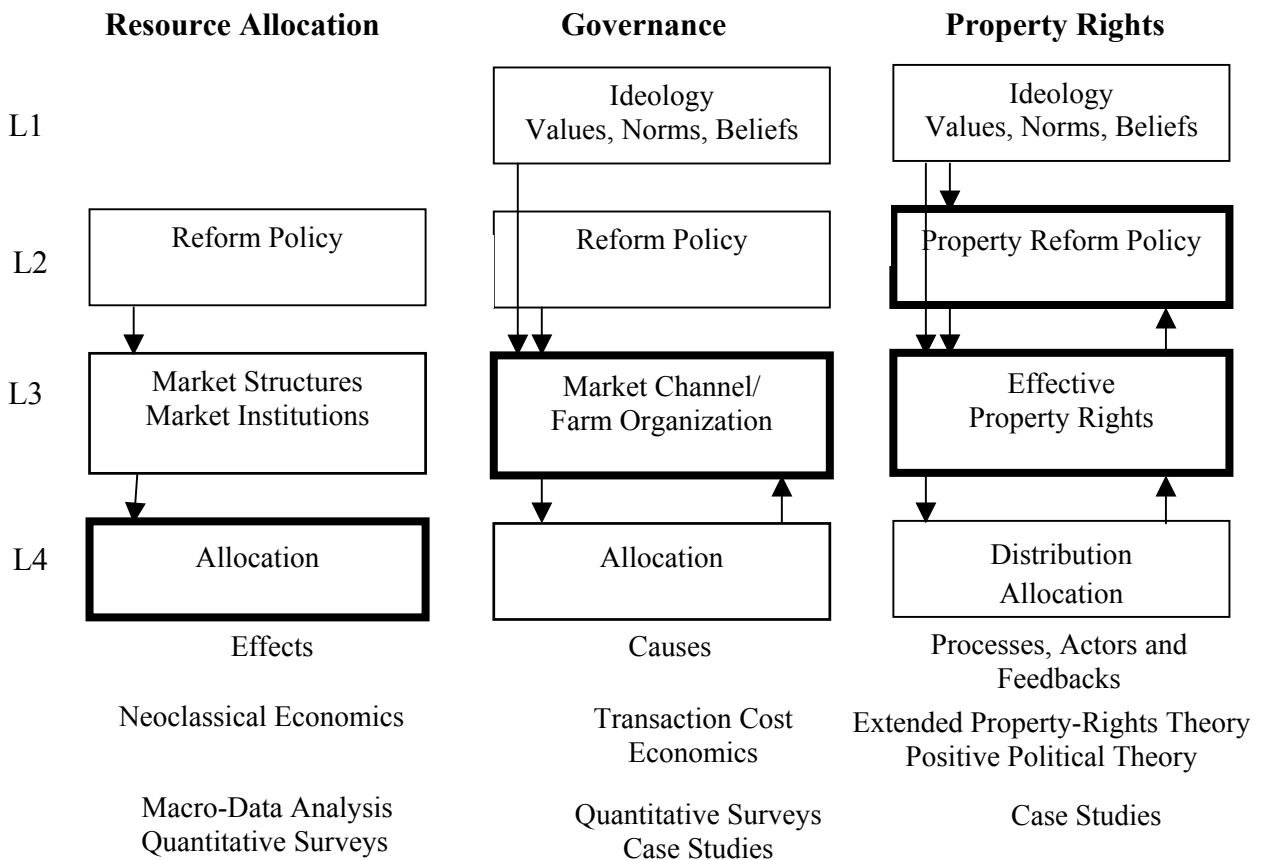
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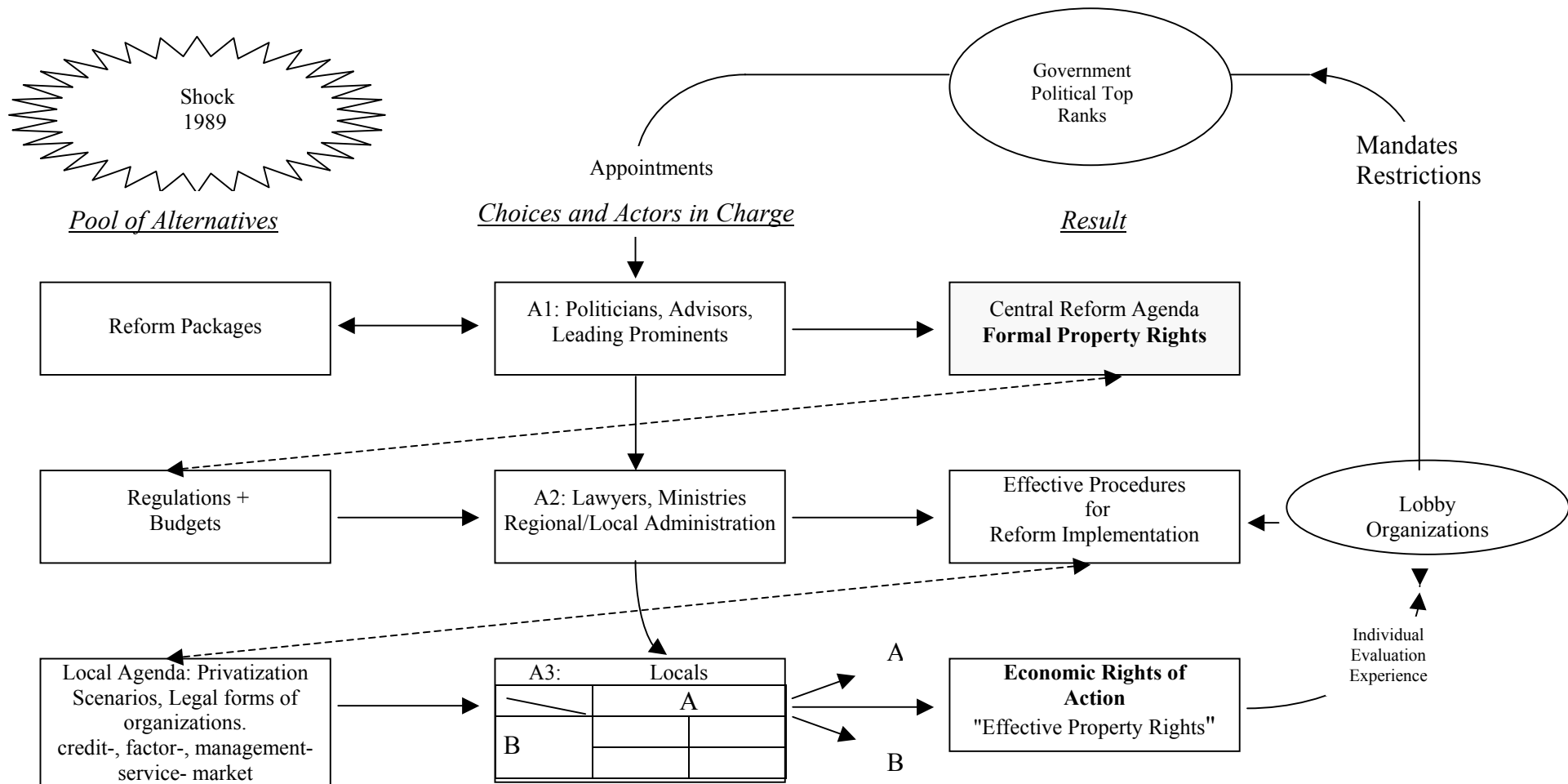


**Figure 1 Four Levels of Social Analysis**

Source: adapted from Williamson (2000: 597).



**Figure 2 Analytical Levels of the KATO Project**



**Figure 3: The Property Rights Process**

Source: Hanisch and Schlüter 1999

A1: Public Choice Theory, Property Rights Theory, Theory of Collective Action  
 A2: Theory of Collective Action, Agency Theory, Theory of the Bureau  
 A3: Transaction Cost Theory, Distributive Bargaining Theory, Theory of Collective Action, Sociological Analysis of Power.

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