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Institutional changes for agricultural and rural development in the CEEC and CIS region

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Abstract*: The paper emphasizes the importance of embedded institutions for the transformation of the agricultural sector and rural economies in the transition countries and identifies and analyses institutional aspects regarding agriculture and rural development common to the transition countries. It focuses on the institutional dimension of reform policies, i.e. on the political economy aspects of the transition process that were decisive for the success or failure of the reforms. The importance of identifying the "mental models" of various stakeholders during the transition process is emphasized and the reasons are explored why the transition process in the countries of Central and Eastern Europe has not resulted in a restructuring of the agricultural sector towards family farms as most were expecting. The paper then discusses the role of institutions for the governance of farms, the comparative advantage of farm sizes and the choice of specific legal forms of farms.*

Keywords: *Transition countries, agriculture, agricultural reform, agricultural policy, rural development, farm structure, institutions.*

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Introduction

Research over the last decade has contributed to a change in the understanding of transformation and growth. It is now generally accepted that transformation is more than a technical matter, and that growth is not based mainly on resource endowment. Instead, institutions are highly important, even if the term is not always well defined. North (1990) suggests a clear distinction between institutions and organizations: institutions constitute the rules of the game, while organizations, which are groups of individuals bound by common objectives, are comparable to the players in a game. Such a distinction is helpful in framing institutional problems. In contrast to North's definition, the World Bank (2002) suggests that the term "institutions" refers to both rules and organizations. Recognizing the close interaction between institutions and organizations, this article utilizes North's definition of institutions, as is commonly done in institutional economics, but includes the analysis of organizations as well. Both are important for transition.

Institutions and organizations are crucial for productive activities within a country and between countries. Productive interactions aim at increasing welfare through division of labour, but this specific form of cooperation generally implies some loss in autonomy and some uncertainty. The first causes less concern if the latter is limited. It is the main task of institutions and organizations to reduce the uncertainty associated with the outcome of interactions and, thus, to improve overall welfare in a society.

Williamson (2000) distinguishes four levels of social analysis of institutions. The most basic set of constraints that shapes human behaviour in the society forms the so-called 'embedded institutions', which Williamson suggests as the first level of social analysis. Examples include traditions, cultural beliefs and religions. The second level consists of the rules of the game and in particular, how property rights are defined and established. The third level constitutes the play of the game, i.e. how the rules from the second level translate into actions of the economic agents. The traditional focus of institutional economics lies in the second and third levels of social analysis. The neoclassical analysis belongs, in Williamson's classification, under the fourth level of social analysis.

Some institutions may emerge partly from a specific culture in a given society and have evolved over time; others have been formally introduced by a society as a whole or by some of its members in order to facilitate exchange. Finally, some important institutions may have been introduced informally by certain special interest groups in order to improve their particular well-being. The informal institutions may conflict with formal institutions and may reduce their effectiveness. Embedded institutions also affect the functioning of formal institutions, yet they have been largely neglected by Western economists when giving advice to transition economies.

This article will emphasize the importance of embedded institutions because they may be of special concern for transforming the agricultural sector and rural economies given that rural societies are often more constrained by tradition and cultural values than urban societies. Research over the last decade has shown that the same set of formal rules may have different consequences depending on the economic and cultural situation in the country at the outset of transition. Culture is defined "in purely subjective terms as the values, attitudes, beliefs, orientations and underlying assumptions prevalent among people in a society" (Huntington, 2000). Culture is part of the embedded institutions of a society and is reflected in the mental models of individuals. These models contain "deeply ingrained assumptions; generalizations, or even pictures or images that influence how we understand the world and how we take actions" (Senge, 1990). A mental model consists of beliefs, inferences and goals that are first-person, concrete and specific. It is a mental map of how the world works. Mental models can be changed and may have to be changed if a society wants to prosper (Fairbanks, 2000).

Institutions in a country or society are specific and change over time. It is almost impossible to identify the total set of institutions that hinder the effective use of resources in a large group of countries such as the Central and Eastern European Countries (CEEC) and Commonwealth of Independent States (CIS). The task is even more difficult if the countries under consideration differ significantly in their stage of transformation, their culture and, therefore, in the importance of embedded institutions and the establishment of formal and informal institutions. As stressed by the World Bank, "Where countries are today affects where they can go" (World Bank, 2001).

Nevertheless, it is possible to identify some commonalities concerning weaknesses of institutions and organizations and to recommend remedies. Assessing the weakness of specific institutions requires referring to specific countries; the interrelationship between the institutions in a given country causes identification problems for cross-country studies. Due to lack of data and empirical studies the general hypotheses posed for a large set of countries, which may include the CIS, the CEECs, the South Eastern European Countries (SEECs) or others, will be supported by empirical evidence from the Russian Federation and Ukraine.

Institutions and organizations are main determinants of the structure, conduct and performance of the political market for policy reform. The effectiveness of policies depends to a large extent on the acceptance of policy reform by the population at large. But even if policy reforms are not supported by the society at large, they need to be favoured at least by some stakeholders. Developments in some of the CIS over the last decade have raised doubts about whether reform policies received even minimal support from some stakeholders. Available surveys in some of these countries can be used to identify the interest in reform of the main players in the political market. With this information, policies can be designed taking into account the perceptions of the main stakeholders and strategies can be developed to change some of these perceptions where advantageous.

Another commonality concerns weak public and private governance, especially in the agricultural sector. Weak governance is a main cause of inefficient use of resources in CEEC and CIS regions. Private governance problems are most significant in those transition countries that, like some CIS countries, still rely on a large-scale agricultural sector. The Russian Federation and Ukraine are extraordinary cases in this context because they are affected by specific institutional and organizational problems. These difficulties serve as cases in point for the general hypotheses developed in the second and third sections of the article. The article concludes with suggested areas for future research in the interrelationship between transformation of the agricultural sector and corporate governance.

The political market for policy reform

Past experience with the transition process from plan to market has shown that in most cases policy reforms did not have the expected results.[1] Looking at the political market for policy reforms, this section identifies various reasons for this failure:

- Policy reforms are badly designed.
- Policies are not based on advice given by policy advisers.
- The policy advice may be inadequate or policy-makers do not follow the advice given because they have different perceptions of the needed reforms.
- Policies are not well implemented and become ineffective.
- People react differently than advisers and policy-makers expected.

This discrepancy between policy advice and policy outcome is particularly evident in many transition and developing countries. One may even question whether policy-makers have ever been interested in advice from foreign experts; the evidence points to the contrary. One objective of this section, therefore, is to analyse the interests of the main stakeholders/players in the political market, their perceptions and their constraints.

Even when countries occasionally accept the advice of international experts, the actual outcome often does not meet expectations. In this section, it is argued that inefficient policy reforms follow from badly-designed policies that fail to take into account the administrative capacity of the country under consideration, as well as the embedded institutions prevailing there. A genuine policy reform has to take into consideration the microeconomics of prosperity (Porter, 2000), i.e. the constraints resulting from all four levels of institutions have to be taken into account.

The important role of the first level – embedded institutions – can be illustrated by considering the eminent role of mental models. We will show how these mental models partly explain the behaviour of the main stakeholders/players in policy reform. Mental models can also explain why policy-makers, the main stakeholders and the society at large often do not support policy advice. Subsequently, we analyse the mental models of the main players in agricultural policy and the interplay between these players based on the institutions in a specific country. In particular, the mental models of those who are expected to react to policy changes (and thus supposedly create prosperity) are explored. To these ends, a number of hypotheses are developed that highlight specific characteristics of the political market in a transition context. Starting from this analysis, we explore possibilities for changing mental models, as well as strategies necessary to design polices within the given constraints of a particular country.

Although mental models are significant parts of a country's institutions, the institutional environment as a whole is important. The institutional environment includes the total set of formal and informal rules: institutions on the second level, which define the rules of the game, are as important as the institutions on the third level, which determine the play of the game, e.g., when some rules are breached and not sanctioned, or when opportunistic behaviour is encouraged. The evolution of policy reform may be highly affected by organizations created in the past in response to specific policies. Policy decisions made in the first phase of transition concerning privatization of land have given birth to a specific group of stakeholders and these may have affected – and may continue to affect – the path of policy reform in agriculture either positively or negatively.

Policy reform in a transition context

Policy reform is not just a technical matter. Policy-makers do not maximize a well-designed social welfare function; rather, the society is segmented into distinct groups, which often pursue separate and sometimes conflicting interests. The individual players in the political market for policy reform are constrained by the status quo. This initial setting is determined by the interaction of the set of all players, the rules of the game at any point of time and the results of past plays, which led to the existent distribution of wealth, income and structure of the economy. Consequently, the evolution of policy reform is highly path-dependent. Although policy-makers have some choice in influencing the course of policy reform and its outcome, these choices are limited by past decisions.

1 Selected references on the problems of meeting expectations during transition include EBRD (1999) and Stiglitz (2000); for the process of agricultural transition in particular EBRD (2002), Lerman et al. (2001).

In addition, policy-makers – even if benevolent – may lack the information to serve the best interests of the society at large. They may be ignorant about the causal relationships between the decision chosen and their effects or they may simply not know what is best for the society at large. The latter point is supported by informal discussions with some left-oriented members of parliament in transition countries. These politicians may propose policies they perceive to be in the interest of the society at large but that actually have negative outcomes because the politicians' perceptions are not in line with economic realities. One important task of policy reform is to clarify what ought to be and how it can be achieved.

If the ultimate objective is to create prosperity, changes must come not only from policy-makers, who create the enabling environment for change, but also from the general public. If the public is not convinced that the enacted policy change is in its interest, it may prevent implementation or its traditional attitudes may prevent the reform from succeeding. Any policy reform – particularly in transition countries, which have to transform a whole economic system – requires a new set of institutions designed to change the mode of coordination of individual decisions. These new institutions, which are supposed to create prosperity by changing people's behaviour, constitute transformation on a large scale. People's behaviour does not only depend on economic incentives, however, but also on embedded institutions. To quote Alan Greenspan, Chairman of the United States Federal Reserve Board, "Capitalism is not human nature"; but as the Russian Federation disaster indicated, "Not nature at all, but culture"(quoted in Pfaff, 1999).

In this context, Huntington's definition cited above underlines the multiple facets of "culture" as a reflection of values, attitudes, beliefs, etc. The acceptance of policy reforms depends on the given culture in a society. Mental models are the micro-level basis of culture because they describe the underlying beliefs that influence the way people behave (Lindsay, 2000), i.e. how they think the world works. Mental models are crucial to understanding the willingness of people and a society to change. Effective policy reform in a transition country will ultimately have an effect on culture if it changes the mental models of at least some people. Of course, the culture does not have to change drastically for the policy reform to work, but the main players in a country must be convinced that the planned reforms will eventually lead to higher prosperity and are therefore desirable.

Characteristics of mental models relevant to agricultural transformation

Mental models are part of embedded institutions, which include informal rules, customs and mores as part of culture, people's attitudes, perceptions, beliefs and cognition (Williamson, 2000). There is ample evidence that embedded institutions differ among societies and that they have significant implications for prosperity. Embedded institutions have an influence on the way policy-makers react, how they collect and deal with information and how they prefer to design policies. Moreover, the institutional environment (second-level institutions, by Williamson's definition) and those (third-level) institutions that determine the play in a country have repercussions on the impact of the behaviour of policy-makers. Research on these institutions could form the basis for the design of a genuine policy reform.

Those who have been engaged in policy advising in transition or developing countries have often realized that the lack of some rationality in policy design is frequently due not to a lack of knowledge on the part of policy-makers (what has and should be done is often obvious, even for a layman), but rather, poor decisions "may result just as much from the decision-makers distorting economic policies for their own interest" (Jain, 2001). Alternatively, poor decisions may emerge from policy-makers' value judgements, i.e. their perceptions of what the world could be, and their understanding of causal relationships. Studying mental models and institutions is the basis for a sound policy reform.

The main players in the political market for policy reform

Because stakeholders and their perceptions are crucial for the design of an efficient policy reform, it is appropriate to first identify the main players in the political market for policy reform and second, to analyse strategies for designing a reform.

The influence of relevant stakeholders at any given moment differs across countries as institutions differ. Past reform and non-reform policies may have had an important influence on the set of feasible policy options that a country has at a particular time. These distinct differences over time and countries do nevertheless exhibit a common pattern, which may be condensed in five hypotheses with particular importance for the political market for agricultural policy reform.

Hypothesis 1: **Past policy decisions have affected the structure, conduct and performance of political markets; in particular, early privatization policies created new stakeholders interested either in further policy reform – mainly by securing property rights – or in blocking further reforms by inhibiting further private ownership in agriculture.**

The mode of privatization may have created a strong lobby for securing property rights if the new owners feel that they could use their property more efficiently if it were better protected. This outcome can only be expected if privatization has led to personalized ownership with personal direct use of the property. If privatization has led to collective ownership or personal ownership that is used collectively, there will be less lobbying for securing property rights. It is not a surprise that the CEECs, which created personalised ownership in the first years of transition, enjoy more highly secured property rights in agriculture than the CIS – which limited private ownership – have.

Hypothesis 2: **The mode of privatization has affected the political market for policy reform and has had an impact on the change in mental models.**

Transformation requires that people learn to change their behaviour and attitudes to risk. It also requires that they learn to gather and process specific information in new ways. Pressure, incentive or both might increase the speed and substance of the changes. One might expect that the break-up of the old farming system in the CEEC and CIS region exerted pressure and incentives to change because the old behaviours were not possible any more. People could no longer rely for decision-making on the hierarchy in place during socialist times; instead, they had to take responsibility upon themselves. Socialist legislation that impeded changes in large farms delayed the birth of privately-owned farms. Labour legislation and issues concerning corporate governance of large farms were extremely important. Those CEECs and SEECs that dismantled the old farm structure either by restitution or by allocating property widely among the population suffered less from the legacy of the people's socialist behaviour. In particular, labour legislation and the old style of public and private governance obstructed the restructuring of the agricultural sector less when the old farm structure was dissolved at the very beginning of the transformation process. The poor performance of the large-scale sector in Ukraine[2] (even worse than the whole economy) coincides with merely minor changes in the effective management of farms over the first decade of transition.

> ***Hypothesis 3:* The creation of new collective farms (i.e. those farms which succeeded the former collective and state farms) has given birth to new players in the political market and has strengthened some players while weakening others. This concerns farm managers, regional governments and the central government.**

Farm managers on the new collective farms were interested in stabilizing the large-scale farm sector. The new environment created by the mode of privatization and the establishment of the new collective farms increased the income-earning capacity of the managers in most cases. The principal agent problem between capital owners and managers, which is inherent in large-scale agriculture, was and still is pronounced on the new collective farms. It is difficult to control managers because no single principal is strongly interested in doing so. The capital owners (the members of the collective) are not really interested because information costs are high and being on good terms with the manager may be of greater personal advantage. Regarding the principal agent problem between manager and workers, the manager may not monitor or enforce labour contracts, allowing individuals to extract rents from the collective (theft, working less, getting access to cheap feed and machinery services).

Regional policy-makers and administrators would have less power if smaller family farms replaced current collective farms. At present there exists a co-dependence between regional policy-makers or administrators and the collective farms. The former group can extract rents from the farms and is more likely to be able to provide sufficient food for the regional population. The latter can expect to get access to scarce and often regulated inputs more easily and on privileged terms.

Policy-makers at the central government level are mostly concerned with food security in terms of prices and availability. They often believe that food security would be at stake if market forces were governing the agricultural sector. Moreover, the political will to secure

[2] See, for example, Csaki and Lerman (1997) and Koester (1999).

food security by domestic production leads to heavy market intervention and control of agricultural production. Policy-makers in transition countries seem to prefer mainly interventionist measures with high regulatory intensity. Policy measures of this type are more easily implemented for a large-scale farm structure because the number of addressees of each intervention is relatively small. According to this perception a large-scale agricultural sector can serve the political objectives better than a small-scale sector. There is a strong alliance for conserving the collective farms or at least a large-scale farm sector.

> ***Hypothesis 4:*** **The lack of an adequate system of public finance, which would permit financing the social health and education systems in rural areas, has created stronger support for the survival of the large-scale farm sector in the CIS.**

The collective farms in many of the CIS still provide some social services for the rural population. According to Ukrainian law, the municipalities were supposed to take over this task from the collective and state farms but they suffered from lack of funds. Therefore both the municipalities and the members of the collective farms are interested in the survival of the collective farms. Even if there is strong evidence that the collective farms have not used their resources efficiently, the rural population may nevertheless be better off fighting for the survival of the collective farms.

> ***Hypothesis 5:*** **The strength of individual players in the political market is dependent on, among other things, the performance of the agricultural sector. Political support for the sector is easier to obtain if its income situation is rated badly.**

Provision of food ranks high on the agenda of most policy-makers. In theory, when markets are functioning in an open economy, food security should not be an issue, and agricultural products should not be treated differently than any other product in the economy. However, markets do not function well in transition countries, there is high unemployment, rural finance markets are incomplete or non- existent, provision of public goods is inadequate, etc. So concerns about the availability of sufficient and adequate food without governmental intervention in the market may be legitimate. A decline in domestic food production may cause concern that not enough food can be provided on the national or regional level. Policy-makers will more likely lend a favourable ear to the demand of agricultural producers for political support if they identify the poor income situation of the sector as the main cause for the decline in food production.

In conclusion, agricultural policy reform is highly dependent on the path set. Decisions in the early stages of transition have affected the political market at later stages and have affected the paths that agricultural policy reform has followed in each country.

The main players in agricultural policy reform

The strength of the individual players in the political market may vary across countries, but the main players seem to be the same. They usually include policy-makers at the central and regional level, academics, bureaucrats, farm managers, agribusiness managers and landowners. Land users other than large-scale farm managers, e.g. the newly-established private family farmers and household plot farmers, have until now failed to take a more active role in the political market of the transition countries (with the exception of Poland). The role of these groups is to some extent constrained by the common interest, which these stakeholders share. Each group's understanding of what should be done and of the effects of past policies matter for the design and outcome of policy reform.

The behaviour of individual players depends on their personal objectives and their constraints. It is widely recognized that institutions – which include a country's legislation and its enforcement as well as informal rules imposed by the shadow economy – constitute important impediments to change. But the importance of embedded institutions, in particular the role of mental models for the behaviour of players in the political market, has received less attention in the case of agricultural policy formation in transition countries. As stated earlier, for policy to change it is first of all necessary to change the mental models of the main players in the political market and the perceptions of the members. Unfortunately, not much empirical evidence is available, but some surveys from the Russian Federation (Interfax, 1997; Schulze *et al*., 1999; Bodganovsky, 2000; Serova, 2000) indicate the importance of policy-makers' mental models.

Table 1 presents an overview of selected elements from the mental models of the main stakeholders in Russian agricultural policy reform.

Table 1

Mental models and main stakeholders in Russian agricultural policy reform

Elements of mental models	Policy-makers on different regional levels	Acade-mics	Bureau-crats	Agribusiness and farm managers	Land-owners	Public at large
Perception of role of the state, especially vis-à-vis income provision	The state as grabbing hand, acceptance of social responsibility	State as helping hand	State as helping hand and grabbing hand	State as protector of the status quo	Inactive	State as helping hand
Attitude with respect to transparency	Negative	Negative	Negative	Negative		Negative
Perception about food security	State responsibility	State respon-sibility	State respon-sibility	State responsibility	Inactive	State respon-sibility
Land ownership, willingness to transfer it	Negative to positive	Negative	Negative	Negative	Positive; reluctant	Negative
Perceptions of superiority of large-scale farms vs medium-sized family farms	Favour large farms	Favour large farms	Favour large farms	Favour large farms	Favour family farms	Favour large farms
Attitude with respect to risk	Risk averse	Risk averse	Risk averse	Hetero-geneous		Widely risk averse
Attitude with respect to changes	Heterogeneous	Negative	Negative	Changes over time	Reluctant	Reluctant

Source: Author's compilation from Bodganovsky (2000) and Serova (2000).

The first three rows in Table 1 explain a great deal about the active role the state is supposed to play in the agricultural sector, according to all players in the policy reform process; the first row indicates their consensus on the issue. However, the notion of the "grabbing hand" among policy-makers and bureaucrats (direct members of government organization) conflicts with the expectations of the other stakeholders. Nevertheless, since all players agree in their negative attitude towards transparency (see second row), this conflict is not perceived as a critical issue; the lack of information on a course of action allows for virtual coexistence of the grabbing and the helping hand in government conduct. The perception of the role of the state in securing access to food (row three) reunites all stakeholders; the overall agreement on this issue again promotes an active role of the state. However, some conflicting positions show up in the remainder of Table 1. The following section discusses these agriculture-specific driving forces for the perceptions of the main players and their implications for the policy reform process.

Important elements of mental models

Several perceptions and attitudes constitute crucial elements of embedded institutions in the process of agricultural transformation.

Perceptions of land ownership, jointly with the willingness and ability to transfer ownership or user rights. The initial mode of privatization would not matter much if land were highly mobile. However, experience has shown that many new owners are not willing to sell or lease out their land. The negative attitude in the Russian Federation with respect to land markets (private ownership and transfer of land) is clearly expressed in interviews: about 90 percent of the respondents disagreed with the concept of land reform (Serova, 2000) and seemed to be against private land ownership. Interviews in Novosibirsk and Zhitomir revealed that only 33 percent of the farmers were willing to mortgage their land (Schulze *et al.*, 1999). Owners seem to be afraid of losing the land. Owning land may be considered an important asset in hedging risk.

Given the constraints on the land market due to the mental models of landowners and the rural population, it is difficult for the sector to adjust to the rapidly-changing environment during the transition period. In particular, the ‘migration of factors’ to the most productive users will not take place if neither private ownership is secured nor land is transferable according to differences in its profit potential. The negative consequence will be a sluggish development of the agricultural sector; the situation is worse if the initial land allocation (as part of the privatization process) was inefficient.

Perceptions of the superiority of large-scale farms as compared to medium-sized family farms. Structural adjustment of agriculture in many of the transition countries is limited by policies that aim to preserve structures from the past, i.e. large-scale agriculture in the form of collective farms or in some other organizational form. This situation, which exists in most of the CIS, results from the perception by policy-makers and other important stakeholders that large farms are superior to other kinds of farm structures. Serova (2000) found that this tendency is of particular importance in countries where collective ownership arose in the privatization process.

Perceptions of the role of the state, in particular with respect to income provision. Interviews with the farming population in the CIS often reveal that people blame their bad economic situation mainly on the failure of the government and not on themselves (Serova, 2000). This understanding has important implications for the efficiency of any policy reform.

Perceptions of food security. Policy-makers in transition countries tend to believe that domestic production is needed to secure food on the aggregate level, and that the first best policy to secure food for poor households is to provide low food prices. Needless to say, these perceptions have had a strong impact on the design of agricultural policy during transition.

Attitudes with respect to changes. During transition policies must change, but people's attitudes must also change. Socialist societies with job security and limited labour mobility did not require significant changes of the population's attitudes in a short period of time, nor of the attitudes of policy-makers and other stakeholders.

Attitudes with respect to risk. Societies differ with respect to their willingness to take risks. According to Harrison (2000), progressive cultures emphasize the future; static cultures emphasize the present or past. Future orientation implies the influence of a progressive worldview over one's destiny, rewards (in this life) from virtue and positive-sum economics. Consequently, progressive societies are less risk averse than static cultures and therefore more willing to change. Generally, people are better-informed on the status quo than on a future status which may result from policy changes. If they are risk averse they rate the status quo higher than any uncertain alternative, even if they are expected to gain from the change. This bias towards the status quo is intensified if past policy reforms have not led to the promised improvement in prosperity, if people perceive the status quo as a viable alternative and if they are not able to assess the consequences of alternative policies. This reasoning helps to explain why many of the transition countries were not consistent in their policies and often returned to policies that were not in line with market orientation.

Table 2 highlights the importance for people's opinions of mental models and possibly badly-designed policies. If a high percentage of the population believes that wealth in their country is more related to connections and dishonesty than to hard work, it will be difficult to find support for a strong market-oriented policy. There is a need to widen the understanding of a market economy and to institute those conditions that will eventually lead to prosperity for individuals and the society at large.

Table 2

Perceptions: Causes of poverty and wealth in percentages

Causes of poverty	**Percentage**	**Causes of wealth**	**Percentage**
Economic system	82	Connections	88
Laziness and drinking	77	Economic system	78
Unequal possibilities	65	Dishonesty	76
Discrimination	47	Good possibilities	62
Lack of effort	44	Talents	50
No talents	33	Luck	42
Bad luck	31	Hard work	39

Source: A survey by Interfax AIF of 1 585 respondents (November 1997).

Strategies to design reform policies

The starting point for policy reform in any transition country is the initiation of a change in the mental models of the main players, and should include strategies to deal with the particular interests of the main stakeholders. Of course, it is difficult to design a blueprint as countries vary significantly; but a general approach seems possible at least in cases where policy-makers are benevolent and are interested in creating prosperity.

Strategies to change mental models

Rural economies in socialist times used to be more static than progressive. Delegation of power and critical questioning of what was to be done and could have been done better were neither encouraged nor desired. These societies had characteristics that significantly differed from those in progressive societies. One way to change mental models is to open up the society through interaction with other societies. The preferred instruments for this type of interaction are personalized contacts between people from different societies. However, this explicitly does not mean that the young people – with their usual high willingness to change – should permanently migrate out. The short-run gain in foreign currency that might be sent back from emigrants is outweighed by far by the long-run dangers of “brain drain”. Rural areas may become poorer if those who are willing to change leave the region and leave behind those who are either unable or unwilling to change.

Opening up a fairly closed society should be achieved instead either by having people from other countries come to the region (temporarily or permanently) or by organizing trips for people to travel to other countries. The first alternative is likely limited, but may be needed. External assistance might be the quickest way towards setting up a more prosperity-oriented research system and introducing more efficient styles of public and private governance. Organized trips are advisable for selective groups of main stakeholders in order to expose them to alternative systems so that as a consequence they may be less opposed to policy reforms.[3] Travelling is but one way; freeing the press, reshaping education and reorganization

[3] It may be worthwhile to remember the Japanese experience and development success which began in the last third of the nineteenth century. “No opportunity for learning was lost. In October 1871, a high level Japanese delegation … travelled to the United States and Europe, visiting factories and forges, shipyards and armories,

of research are also important. Excursions may be the most appropriate for the leaders of the main players in the reform process.

Policy reform imposed from outside often lacks the support of the society at large and may become ineffective due to inadequate implementation or due to adverse reaction of individuals. Successful policy reforms must express the political will of the society. But first the people must be convinced that the policy change will lead to prosperity. It may not be too difficult to convince policy-makers and the public on the need for policy reform, but it will be more difficult to agree on a specific direction. Furthermore, agricultural policy-makers and the main stakeholders have to know the possible effects of alternative policy decisions on food security, resource use and the livelihood of rural regions. A policy debate that includes experience from other countries and encompasses the public could eventually contribute to changes in mental models. The beliefs in food security based on domestic production as a first priority and in the superiority of large-scale or even collective farms have to be challenged. A free press could raise these issues and would be helpful in preparing the basis for a sound policy reform.

It is unlikely that most individuals in a reforming country are either able or willing to understand the need for policy reform and its implications. Education, on-the-job training and extension should rank high on the reform agenda. The experience in many transition countries does not demonstrate recognition of these priorities. The education and research systems have not changed much in most of the CIS countries. Actually, the organizational structure of the research institutes has often not changed; if changes occurred, these occasionally even led to worse outcomes.

Finally, opening up minds and promoting changes in attitudes are very important for the management of the farm and agribusiness enterprises; managers need to be exposed to external views. One alternative would be to set up an extension service for all types of farms and to introduce advisory circles, of a limited number of farms, which would have to open their books on a mutual basis to compare them on the basis of their performance. Although

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railways and canals. They returned in September 1873, almost two years later, laden with the spoils of learning and ‘on fire with enthusiasm’ for reform’” (Landes, 2000). The Japanese experience underlines the importance of opening up a society.

large farms already have a bookkeeping system, there is ample evidence that these data are not very reliable. The methods employed for calculating costs, gross margins and profit is not in line with market economies – and it is very difficult to engage farm managers in discussions on farm performance, in particular in relation to other managers' performance. Introducing such a mutual advisory procedure would also mitigate the principal agent problems on the large-scale farms because it would substantially increase the transparency of the management and make it easier to monitor the managers.

Strategies to deal with the main stakeholders

In their analysis of the Russian reform process, Shleifer and Treisman (2000) focus on the issue of dealing with the main stakeholders. Efficiency- and welfare-enhancing reforms often threaten the interests of certain powerful social actors. These actors can prevent reform, either through centralized action that prevents enactment, or through decentralized efforts in particular locations that prevent implementation (Shleifer and Treisman, 2000).

A radical market-oriented reform process often neglects the interest of those main stakeholders, who would have to be expropriated. They must be deprived of the power to prevent specific reforms that are not in their interests. Such a strategy, possible at the beginning of the reform process, may be a reasonable alternative in some countries. If the public is convinced that a reform is needed and that the final outcome will eventually result in higher prosperity, a benevolent policy-maker may opt for a radical reform. Indeed, the reform might be sustainable if positive results are visible promptly. If a positive outcome does not materialize, the radical reform process may be stopped and even reversed, with highly negative consequences for the transition policy. Indeed, in many instances, well-intended radical reforms were reversed.

An alternative, often followed in transition countries, is to co-opt the main stakeholders. Co-optation does not imply dealing the stakeholders out of the game but rather dealing them new cards. The reform entrepreneurs do not remove the stakeholders' veto power, but create incentives for them not to exercise it by giving some benefits to the stakeholders in return for their support of reforms (Shleifer and Treisman, 2000). The lack of co-optation of the main stakeholders in the reform process seems to be the most important determinant of the inefficient reform process in CIS agricultural sectors. The recent change in farm structures in the Russian Federation and Ukraine is supported by the changes in the interests of the main stakeholders, the farm managers, the agribusiness managers and the large non-agricultural operators. They were able to benefit from the reform process in recent years because they had accumulated financial means and could take advantage of the newly-passed tax legislation (Koester, 2003).

Corporate governance in the context of transforming agriculture in transition countries

The problem stated

The analysis of corporate governance and its relevance for economic development has its foundations in the finance literature, under the heading of addressing "the ways in which suppliers of finance to corporations assure themselves of getting a return on investment" (Shleifer and Vishny, 1997). The literature on corporate governance is generally based on the premise that the main corporate governance problem is self-interested management and weak, dispersed shareholders (Berglöf and von Thadden, 1999). It is likely due to this particular framing of the governance problem that this issue has not been ranked high on the research agenda of agricultural economics. Most farms in market economies are run by managers who own the major share of the farm assets. This holds true even for tenant farmers. Consequently, the conflict of interest between the manager and the shareholders is absent in most agricultural sectors in market economies. The situation is significantly different is many transition economies.

Moreover, the problem of corporate governance in transition countries, in particular in the agricultural sector, is wider than stated above. "The market-based governance approach should be broadened to include the problem of owner-controlled firms and large block-holders, but also should be generalized to a model of multilateral negotiations and influence-seeking among many different stakeholders and outside constraints and must take into account the effects of a country's legal and political system of these check and balances" (Berglöf and von Thadden, 1999). In particular, the interaction between corporate governance arrangements and the political system is of relevance for governance of alternative types of farms in transition countries. These topics should be included under the heading of corporate governance. Corporate governance can be defined as the set of mechanisms that translate signals from product and input markets into firm behaviour (Berglöf and von Thadden, 1999). This broad definition leads us to highlight the following issues in the agricultural policy reform process of transition countries.

The importance of analysing the institutions is in part to reveal the existence of alternative types of farms in a country. Types of farms can be classified as follows:

1) new collective farms as successors of the former kolkhozes and sovkhozes;

2) cooperative farms that often succeed the new collective farms or may have emerged directly from kolkhozes and sovkhozes;

3) corporate farms in the form of limited liability companies or other legal forms;

4) holding companies (synonymous with agro-holdings), which may include agricultural entities, processing and input supplying firms and others, such as Gazprom in Russia, or banks;

5) private farms either in the form of single ownership organized as family farms or as large-scale farms, based on hired work;

6) part-time farms; and

7) household farms (synonymous with household plots).

It is mostly private farms under family management and part-time farms that have importance in market economies. In contrast, they are of minor importance in most transition countries. Some of these countries – mainly the Russian Federation, Belarus and (up to recently) Ukraine – still rely mainly on collective farms and household farms (Lerman, 2001). Other countries have moved quickly to private farms, but the farms are hardly large enough in size to grant a living. Of particular interest are recent changes in the Russian Federation and Ukraine: holdings – even if they are forbidden by law – have emerged on a significant scale in the Russian Federation and on a less important scale in Ukraine. Household plots are a phenomenon typical for the agricultural sector in transition countries. These are characterized by a very small scale of production, high labour/land ratio and few formally-obtained intermediate inputs. This organizational form is barely existent in developed market economies, but accounts for up to more than half of all agricultural production in some countries.

Institutions that affect the comparative advantage of specific types of farms in a country are partly first-level institutions (Williamson, 2000). These are informal rules based on a country's past, including cultural beliefs, norms and values of the society and tradition-laden behaviour. The latter might be of special concern for the selection or the performance of specific types of farms. The existence of specific types of farms also depends on the institutional environment (rules of play) and how those institutions are implemented (the play of the game).

Reaction to market signals may differ for alternative types of farms, depending on institutions on the farms, but also on the institutional environment and its mode of implementation. The reaction may be large or small depending on the degree of awareness of changes in the environment and the willingness and ability to react. All of these determinants are affected by institutions.

The reaction of specific types of farms to changes in market signals is of importance for policy-makers. Markets in transition countries are not functioning well. There may be significant divergences between social and private marginal costs; moreover, market prices do not always reflect shadow prices from an economic point of view. Market signals may induce adjustment that is rational from the private point of view, but not from the point of view of the society at large. Divergences on the labour market in rural areas are one main cause of the problem; others include the market power of buying and selling agencies and the interrelationship between farms and the social sphere. These divergences may induce policy-makers to intervene in decisions on the farm, but more so on farms of specific types, such as collective ones. The response to market signals may be hampered for collective farms due to restrictions (formal or informal) imposed on them by bureaucrats or policy-makers.

These issues deserve more attention. Farm structure (with respect to types of farms, size and pattern of production) changed marginally in most transition countries only after the first initiatives by the governments to restructure the sector. It is widely accepted that further restructuring is needed in all countries, albeit with different requirements, but the speed of restructuring is slow. It is worth investigating why farm structure is so stable over time and how structural change can be accelerated.

A few countries have witnessed significant changes in farm structure in the last years, namely the Russian Federation and Ukraine. Collective and household farms dominated both countries' agriculture up to 1999, but a new type of farm has emerged over the last two years: the so-called agroholding. We present some hypotheses for the stability of the structure over nearly ten years and for the recent changes.

Corporate governance and the stability of farm structure in main CIS countries

> ***Hypothesis 1:* The formal institutional framework, which was (or still is) decisive for the collective farms, created corporate governance problems.**

Important second-level institutional characteristics were (and may continue to be):

- no clear distinction between interests of capital owners and workers;
- labour law legislation that made it impossible or costly to dismiss workers;
- wage level changes determined or accepted by the collective farm's assembly of members;
- rules for exit of members from the collective farm;
- rules for hiring a manager; and
- rules for distributing profits among capital owners and workers.

Hypothesis 2: **Collective farm governance played a minor role in the restructuring of the sector, as governments intervened strongly. The main causes of the delays in adjustment were not the rules of the play (second-level institutions), but the play of the game (third-level institutions).**

Important third-level institutions were or still are:

- allocation of subsidies by the central or regional governments;
- allocation of inputs, in particular fuel, by the local administration;
- enforcement by the local government of a specific pattern of production;
- granting of credit by government bodies through acceptance of delays in payment (soft budget constraints);
- granting access to subsidised credit;
- impeding the exit of farm members by delaying the process of granting access to land and other assets; and
- theft.

Hypothesis 3: **Governance on the collective farms was significantly affected by the interaction between the collective farms (mother farms) and the household plots**.

Important institutions were or still are:

- provision of products and services at so-called ‘at-cost prices’ to household farms;
- theft of production factors;
- payments in kind for work delivered;
- the value-added tax system; and
- the income tax system.

Hypothesis 4: **The slow emergence of private farms is partly a corporate governance problem.**

The main institutions were or still are:

- lack of entrepreneurship and lack of know-how;
- policies creating uncertainty, which affected reactions to market signals;
- uncertainty created by discretionary decisions of policy-makers and bureaucrats, which affected the expansion of the private farm sector; and
- discrimination by public authorities.

The consequences of the above hypotheses were so far-reaching that production in most transition countries declined over time and the production potential of the collective farms, measured in terms of resource endowment, eroded. The prospects of collective farms are dim, to say the least.

Corporate governance problems in the recently-emerging farm sector in the Russian Federation

The situation in Russian agriculture is characterized by significant restructuring over the last two years, where a new type of organizational form emerged under the responsibility of new, mostly outside operators. Rylko (2001) interviewed on and analysed a sample of 16 such agroholdings, and found that the average enterprise size is very large as compared to market economy standards. Fourteen had an average size of nearly 37 000 ha. One of them controlled 19 collective farms in two regions with a total size of about 150 000 ha. The mother enterprises are usually active in different sectors, including those close to agriculture in the value-added chain, such as processors, input suppliers or custom farming. Others, such as Gazprom, had no direct production ties to agriculture. Unfortunately, precise information on the significance of this new form of operation is not available, but Rylko estimates that they have about a 10 percent share of arable land in the Russian Federation. However, they are not uniformly distributed all over the country but concentrated in regions with fertile soil. More recent estimates (Zimmermann and Schüle, 2003) are lower with regard to the share for the Russian Federation as a whole (about 3 percent of arable land) but confirm the high concentration in selected regions (Orjol: 31 percent of Utilized Agricultural Area (UAA); Belgorod: 36 percent of UAA).

The motive behind this change is not quite clear. Rylko performed interviews in which the following answers were given (though they probably do not reveal the real reasons): “We got tired of non-paybacks by farms and decided to control the whole production chain.” “We wanted to receive necessary quantities of inexpensive quality raw material on a timely basis.” “We thought that agriculture was a good place in which to put money.” One operator expressed what was on the minds of others: “We don’t see any reason why agriculture in the Russian Federation cannot be a highly profitable business. You only need new assets, new technology, new management and new people” (Rylko, 2001).

The real motives are likely different ones – that is, economic or political. One motive might be in order to take advantage of the exemption from profit taxes in agriculture and of the fixed asset tax (OECD, 1998). Integration of agriculture with non-agricultural enterprises could allow for the shifting of profits to agricultural enterprises, thus lowering the overall tax rate. Moreover, it is quite obvious that these enterprises may have significant political influence. They are the main employers in rural areas and can expect to be taken into account in the political decision-making process. The influence might be reflected in the current land law, which includes a right of pre-emption for the person or legal entity that has farmed the land over the last three years (Zimmermann and Schüle, 2003).

> ***Hypothesis 1:*** **The new type of agriculture, with up to 500 000 ha under the umbrella of a holding, will likely create highly capital-intensive farms.**

Given agricultural technology and international prices for machinery, highly capital-intensive production methods may be superior to less capital-intensive ones in certain activities, even at very low labour costs. The superiority of a highly capital-intensive technology is evident mainly in those sectors where it produces higher yields due to superior cultivation, superior harvesting and/or superior dosages of yield-increasing inputs (precision farming). Such methods become even more advantageous if the farm’s cultivated area is large or if the farms have access to customs services.

The comparative advantage of large-scale farms depends to a large extent on corporate governance; the main problems are related to the monitoring and enforcing of labour contracts. Technological progress in communication (which has lowered transaction costs related to labour monitoring) and production has increased the comparative advantage of large-scale farms in specific production activities. Furthermore, capital intensity will increase if there are restrictions on hiring and firing labour and/or if enforcement of labour contracts is difficult due to traditional behaviour of workers or due to formal or informal rules. Large-scale farms in particular will favour those products that can be produced with high capital intensity. It can be expected that the tendency towards capital-intensive methods will continue for the foreseeable future. (See parallels in the structural development of East Germany.)

> ***Hypothesis 2:*** **Transforming agriculture to large-scale farms may improve the private return in agriculture, but it may lower the economic return for the society at large. Moreover, it may create social problems.**

The present restructuring of the agricultural sector in the Russian Federation is partly a reaction to market signals, but the market signals confronted by private decision-makers are distorted. The tax system, with lower profit taxes in agriculture than in other sectors, favours investment in agriculture. The market price for labour is higher than the shadow price, meaning that private decisions on factor intensity do not lead to an optimal result from society’s point of view. If increased efficiency in agriculture leads to unemployment (while the unemployed still have a positive marginal productivity), the efficiency of the overall economy, which should be the central objective of any economic policy, is not improved. In addition, it is probable that increases in the already huge rate of rural area unemployment will cause social hardship and political unrest. Finally, the new farm structure may shift the economic and political power in rural areas towards the operators of the large-scale farms, with long-lasting repercussions on political decision-making and the distribution of income.

Corporate governance problems in the recently-emerging farm sector in Ukraine

In Ukraine, the structure of main players in agricultural production has changed significantly over time: Until the end of 1999 the typical agricultural enterprise in Ukraine was the

Collective Agricultural Enterprise (CAE), which farmed about 58 percent of the total agricultural land in use by agricultural enterprises.

Table 3
Number of agricultural enterprises in Ukraine

	On 1 December 1999		On 1 December 2000	
Organizational and legal form of enterprises	Number	Percentage	Number	Percentage
Collective Agricultural Enterprises	8 102	63.8	-	-
Agricultural companies	1 803	14.2	6 761	50.0
Agricultural cooperatives	284	2.2	3 325	24.7
Private enterprises	470	3.7	2 901	21.5
Others	2 041	16.1	500	3.8

Source: Preliminary data of the Ministry of Agricultural Policy of Ukraine (2000). Quoted in Puhachov and Puhachova, 2001.

Private farms played a minor role until December 2000 (when they numbered about 35 000). The figures for 2001 indicate a substantial increase in numbers, to more than 40 000. Their share in total agricultural land amounted to 16.5 percent in 2000, while the average size of these farms doubled between 1998 and 2001, to more than 60 ha. Their share in total agricultural production is generally negligible (about 0.5 percent). On the other hand, the number of household plots is still high, with a share in gross agricultural production of more than 60 percent in 2000.

According to official data, almost 90 percent of CAEs reported losses in 1999, in spite of massive subsidies (von Cramon-Taubadel and Zorya, 2001). Apparently the government eventually became convinced that the CAE as an enterprise type was badly equipped to revitalize the agricultural sector, and on 3 December 1999 issued Decree of the President of Ukraine No. 1529/99 “On urgent measures for accelerating the restructuring of the agricultural sector of the economy” (Puhachov and Puhachova, 2001). The decree ordered that CAEs (as a form of agricultural enterprise with collective ownership) be converted to private ownership-based enterprises – such as private farms, private enterprises, agricultural companies or agricultural cooperatives – by April 2000. Moreover, all members of CAEs were allowed to leave the CAEs freely and to withdraw their land and property shares. Members could cultivate their own land, for example by expanding their household farms, or could start a private farm on their own and/or rented land. In fact, full-time farming required renting or buying land, as the average land share in Ukraine was only 4.1 ha (von Cramon-Taubadel and Zorya, 2001).

The decree may be considered the most important formal institutional change in Ukraine after the first law on land reform of December 1990 (Puhachov and Puhachova, 2001). In principle, it aimed mainly to put into practice what was already officially required by other laws and decrees (e.g. the allocation of property and the possibility of taking out individual shares were already legally possible). Surprisingly, the decree did not share the same fate as many others that were formally in place but not effective. The success of the decree became obvious in subsequent legislation. In 2001, land code legislation was approved by Parliament, and in 2002 a presidential decree announced further rules regarding the distribution of the assets of the former CAEs, expanding the above-mentioned December 1999 decree on land sharing.

The reasons for the effectiveness of this renewed attempt at land privatization ought to be explored. One hypothesis is that the President took the initiative soon after his election in October 1999, relying on momentum to get it through. The time seemed ripe. There was broad consensus that significant changes were needed; agricultural production capacity was eroding continuously and it was evident there was a need for political action. In addition, the institutional environment had changed over time, helping to make the new decree effective. Many managers of collective farms had accumulated experience and funds (or access to them) that allowed them to run farms on their own. Moreover, investment in agriculture became profitable for non-agriculturists, as agricultural enterprises do not have to pay taxes on profits nor value-added tax. Shifting revenue and profit from non-agricultural to agricultural enterprises could pay for an integrated company.

In December 2000, about 75 percent of agricultural enterprises were either agricultural companies (50 percent) or agricultural cooperatives (24.7 percent); private enterprises had increased their share from 3.7 in 1999 to 21.5 percent in 2000. The restructuring process had two phases. During the first phase many managers of collective farms tried to take over the farms by renting the land from the members of the collective farm. Thus, the old farm continued, but in a different legal form. This process was possible because many of the newly-created enterprises did not adhere to the legal requirements concerning distribution of non-land assets. The distribution was simply not executed, which necessitated an additional presidential decree in June 2002. The debt problem – a major problem for many farms – could be solved by splitting the collective farm into two parts: one with assets where the market value was far below the book value and another where the market value exceeded the book value significantly. The process of restructuring gained additional momentum in March 2000 when the President enacted a new decree resulting in forgiveness of public debt for those collective farms that changed their organizational status.

The structural changes initiated removed many obstacles for transforming agriculture in Ukraine, but they created a new situation that is worrisome. It is hardly feasible to effectively restructure the agricultural sector in such a short period of time. The German experience showed that the distribution of farm property can lead to widespread problems of fraud. Property valuation is difficult, as book values differ significantly from market values, and the farm property to be redistributed may be falsely identified. Management may have better information than other members of the collective, but may not be interested in sharing the information – especially if it is interested in expropriating some of the property. Indeed, the experience of Ukraine supports these fears, as in many cases distribution of non-land assets did not take place. Managers who continued on the remaining part of collective farms preferred to keep the farms' non-land assets for free. This situation provided additional rationale for the June 2001 Presidential Decree, which demanded the distribution of non-land assets. It is doubtful that the decree will have much effect, given that the underlying problems with asset valuation and identification remain unresolved. The threat of unsettled claims may persist for many years, undermining social stability in rural areas.

Dissolution of collective farms and the creation of large-scale private farms will have some serious implications for the social sector, rural employment and the political market. Lerman and Csaki (1999) reported that most collective enterprises provided public goods and services to the rural community (although less so over time) – and only a few transferred their social assets as required by law. It is questionable whether the new farms will contribute to the well-being of the rural population to the same extent as the collective farms did. This does not mean that restructuring is not necessary. However, it would have been accompanied by less social hardship if the law on transferring social assets had been enforced and if the communities had been provided access to resources for financing social services. The formal institution governing social assets was not established efficiently and the emergence of the large-scale farms as new organizations (players in the game) gives rise to concern about whether the necessary transfer of the social assets can be enforced in the future.

Repercussions for rural employment in Ukraine will likely be similar to those described above for the Russian Federation. The new farms will increase their capital intensity, shift the production pattern toward more capital-intensive products and lay off workers. Rural unemployment will likely increase significantly, while the availability of public goods and services will decline, giving workers – and especially skilled workers – additional incentives to leave rural areas (even if they are employed). The emerging structure will also have an impact in the political market in the rayons and oblasts.

Summary and further research

This article starts from the premise that an economy’s transition requires large-scale institutional change. Moreover, “there are vast domains of institutional transformation that cannot be achieved simply by the dictates of a proclamation from the central government” (Stiglitz, 2000). The premise leads to the conclusion that the approach of neoclassical economics does not offer adequate guidance for policy reform.

Institutions defined as “rules that constrain human behaviour” are created in part spontaneously or by collective actions, or they may have evolved over time as part of culture and tradition. It is the latter set of institutions – the embedded ones – that are the main focus of the article, as their importance for agricultural transition has been widely ignored by economists.

Even if institutions are largely country-specific, it is possible to identify a larger group of countries' institutions that are crucial for the transformation process. For example, all transition countries suffer from reforms that do not meet the expectations created at the outset of transition. Hence, one focus of the article is on institutional aspects governing reform policies, i.e. on the political economy aspects of the transition process that were decisive for the success or failure of the reforms.

In particular, the article argues that policy reform is not merely a technical question; it comprises more than just setting the proper policy measure in the proper place. Instead, prevailing institutions and organizations in a country are the main determinants of the optimal set of policy instruments. It is important to keep in mind, though, that institutions can be changed. Strategies to design and implement efficient policy reform should be based on the identification of the mental models of the main stakeholders in the reform process.

Agricultural economists have also widely neglected corporate governance problems, since these problems were not particularly an issue for the family farms or single-owner farms that dominate the farm sector in Western market economies. In the early transition phase it was widely expected that the CEECs would quickly restructure their agricultural sector towards family farms. Those expectations have not been fulfilled. The article explores the role of institutions for the governance of farms, the comparative advantage of farm sizes and the choice of specific legal forms of farms.

The above analysis suggests several areas where focused research could help to identify and design policies to ease the adjustment process in agricultural transition. In concluding the analysis, we highlight our point of view through the following enumeration of the most urgent research areas.

Interrelationship between holdings and policy-makers. There is a danger that managers of holding companies gain political power. Specific control mechanisms may be necessary. The implementation of such mechanisms might be facilitated by additional transparency in political decision-making. Research on the political process should focus on the strategic behaviour of the main players and their underlying objectives.

Income generation on large-scale farms, the rural economy and the social well-being of the rural population. Large farms may be able to generate higher rural income than the past collective farms or even than family farms would generate. However, production patterns in rural areas will differ from before the transition and from a family farm-based structure. Concerning agricultural production, it is likely that livestock production will decline in favour of crop production. This change will have repercussions on the downstream and upstream sectors in rural areas, with consequent lower employment in rural areas. The well-being of the rural population also depends on the production of public goods in the form of social services. Research should be conducted on how rural communities could be equipped to provide social services adequate for the reasonable well-being of the rural population.

Large farms versus family farms in the case of distortions of labour markets. Agriculture is apt to be more efficient financially if structured in fairly large farms. The East German case supports this view. However, it is questionable whether a financially strong sector, such as agriculture in East Germany, contributes to efficient resource use in the region in the most effective way. Distorted factor markets, especially wages above the shadow price, may lead to rural unemployment (as in the East German case).

Land market issues. Prospective changes in the land market in the Russian Federation and Ukraine give rise to the economic and political monopoly power of agricultural enterprises. There may be a need to control this power by improving transparency in land transactions or even by enacting a land law that requires the government to approve land transfers. (Some market economies have such laws.)

Tax and subsidy issues. There is a presumption that tax considerations and subsidies have supported the emergence of large agroholdings in Ukrainian and Russian agriculture. The issue deserves more detailed research. Due to specific tax exemptions for agriculture, non-agricultural enterprises may find it profitable to merge with agricultural ones and to save tax and/or to collect subsidies. There is a need to examine the effects of the present system of taxes and subsidies.

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