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Leadership and Importance of Social Capital in Cooperatives during Transition: A Case Study of Two Cooperatives

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Abstract

In Hungary an increasing number of agricultural cooperatives have gone bankrupt or have broken up due to a lack of competitiveness under market conditions, in the aftermath of radical reforms. Others, however, have been able to maintain or even improve on previous levels of success. Individual farmers have also established new cooperatives and are working toward deepening cooperation. The paper discusses the importance of leadership of cooperatives during transition, a topic which is not well addressed in the literature. Production cooperatives are not only economic units, but also social networks. Two successful cooperatives in the same town, one old and one new, have been compared with respect to their social capital, development and leadership. The findings show that, in the traditional agricultural cooperative, a more social oriented leadership has helped to overcome economic, social, and psychological barriers arising during transition, while, in the case of the new co-op, improving cooperation has depended mainly on the increased level of social capital after the radical reforms.

Keywords: Hungarian Cooperatives, leadership, social networks.

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Introduction

Most Central East-European countries (CEECs) had a system of large-scale farms which had to be restructured during the transition to a market system. Prior to the radical reforms in Hungary, agricultural cooperatives (co-ops) had a 48-50 % share in Gross Agricultural Output (GAO) while another 33-35 % came from household production integrated with co-ops. After the end of communism, members of co-ops had to choose whether to continue farming cooperatively or to leave the co-op and start individual farming or establishing partnership. Two major lines of cooperation, a traditional production co-op and a new marketing coop, are evaluated in this paper. The case study is based on research in literature and interviews. Field work was carried out in a traditional cooperative, Béke, and in a newly-established Purchasing and Marketing Cooperative, Hajdú Gazdák (PMCHG).

At the beginning of the 1990s, the existing co-ops from communist times continued their activities. Between seven and ten per cent of co-op members decided to leave their co-ops in the early 1990s. The average size of new individual farmers' holdings was 2-3 ha. Some of them decided to join newly-established cooperatives later on. The paper gives an insight into the motivations of private farmers as well as those of co-op members and underlines the factors motivating private farmers to join cooperatives on the one hand, and on the other, pushing members of traditional co-ops to maintain their cooperation. Besides the directors of PMCHG and of the Béke Co-op, another key person from PMCHG was also interviewed. In addition, based on a standardized questionnaire, five members of each co-op were interviewed. Relevant documents and observations were also used to complete the case study. The objective of the case study is to compare the development of a traditional and a new type of cooperative after radical reforms and to underline key factors affecting cooperation.

Radical reforms

The political changes, which took place in the early 1990s, greatly changed the political and economic environment of farming. The major pillars of the new agricultural policy were: "a) the country must have internationally competitive agriculture, b) subsidies should be reduced to a much lower level, and c) as in the EU, the family farm must be supported in becoming the prevailing structure" (Ministry of Agriculture, 1992).

Only in the case of land was there an opportunity to claim back in physical terms property owned by individuals up to 1949. Due to four laws relating to

partial restitution on assets and compensation in 1991 and 1992, an additional million landowners, with an average of between 1.7-1.8 hectares of land appeared, resulting in fragmented land ownership (Varga, 2000). This is in addition to the existing 1.5 million landowners,

Changes in the institutional framework for marketing products

Concerning institutions, the loss of the old regime's role in helping small farmers to access markets has created the following problems: a) local markets existed and accepted limited supply; but b) the earlier General Consumer and Marketing Cooperatives (GCMCs), which functioned well, mostly disappeared; c) a number of inexperienced new middlemen appeared and started business in the vertical chains; d) production co-ops no longer felt an ethical responsibility for the marketing of products from small individual farmers; e) former procurement and processing companies were no longer obliged to purchase agricultural products; f) social capital in this context was destroyed before building up of a new competitive distribution system; and g) to establish a new system starting from the bottom up needed more time and resources.

There have been several new institutions dealing with establishing a new environment for coordinating market performance under the Ministry of Agriculture and Rural Development, including: a) Office of Agricultural Market Regime, b) Center for Agricultural Intervention, later named Office of Agriculture and Rural Development c) Product Councils (PCs) established by producers, processors, traders and consumers of selected products or groups of products, d) Producers' Organizations (POs).

In addition, some other institutions have also represented the interests of agricultural producers, for example the Agricultural Chamber, the National Federation of Agricultural Producers and Co-operators (NFAPC), and the National Federation of Farmers (NFF).

Transformation of production co-operatives

In 1992, a law was passed detailing how cooperatives should be transformed to meet new requirements and allowing members to leave their cooperative if they wanted. In transformed co-ops three major groups of landowners have appeared; first, people who are really engaged in agricultural production; secondly, retired people who are still co-op members, and; thirdly, 'outsiders' or new landowners not interested in private farming. Besides the land itself, the means of production

(machines and other tools) have had to be redistributed among landowners in the form of co-op shares and business shares. An increasing number of business shares are in the hands of pensioners, resulting in conflicts of interest. Success in restructuring agricultural co-ops and of new co-op developments have very much depended on the expertise of leaders on the one hand and members' trust in leaders and institutions on the other.

Social Capital

As with the other papers in this issue, social capital is recognized as one of the key elements of economic growth. As the level of social capital depends on "a person's connections (whom they know, but also connections through common group membership), the strength of these connections and resources to their connections" (Murray and Beckmann, 2004), social capital and its strength have to be discussed and evaluated in the given socio-economic context. Murray (2007) underlined that the extent of networks of relationship is determined by the prevailing social norms of the group, the necessity for interaction, and individuals' motivations for interacting. Chloupkova *et al.* (2003) have made a comparison of social capital development in cooperatives in Denmark and Poland and concluded that, although levels were similar before World War II, the level of social capital was now higher in Denmark than in Poland, suggesting that under the Communist regime social capital was destroyed in Poland. However, one has to be careful in making general statements on the social capital situation in former socialist countries. First, socialist countries had strong national characteristics. Second, in contrast to other former Communist countries, in Poland small farms dominated agriculture under the socialist system. Third, small farmers in Poland have accumulated sufficient experience concerning their trust towards each other and market players as well as towards government. In Hungary private farming had a marginal role in gross agricultural output after collectivization (1961), but small-scale (household) farming was an important source of income for cooperative members. Cooperative members' trust in their leaders also increased. Vertical cooperation between producers, buyers, manufacturers and traders was deepened and transaction costs decreased.

The decline of social capital after radical reforms

Agrarian reform in CEE countries has been seen from such different points of view as political economy, property rights theory and transaction cost economics.

Valentinov (2004) points out that in all these approaches, social capital has played a decisive role concerning the outcomes of reform. Each approach was shown to reveal some specific aspects of the social capital concept which led to additional findings. It is a fact that social capital substantially declined in CEECs following radical reforms. What were the reasons for this?

First, land ownership has been changed substantially with different attitudes among new landowners to farming and a low level of social capital in the case of new landowners. Second, for a time people have not been sure to what extent the new agricultural policy will be changed. Third, the level of social capital and the cohesion among cooperative members prior to political change, due to successful performance over years, were in many cases high. Trust in leadership has become a decisive factor in the case of many cooperatives in Hungary. Fourth, social capital, social norms, and levels of trust were affected very much by radical reforms. Fifth, the economic environment has not been transparent for years, more people and businesses have broken rules and the value of norms has declined.

The leadership issue

After the introduction of the new agricultural policy in 1990, it was a real challenge for production co-ops to adjust. The question of how high was the level of people's trust in the cooperative as such and in its leaders became a decisive factor. In Hungary only 127 out of 1,441 cooperatives were not able to meet new legal requirements by the deadline and disappeared. Some 10% of members decided to leave their cooperatives. The rest decided to continue their membership. The vast majority of members did not think of leaving the cooperative and farming on their own. This was also evidence that people's trust in cooperative leaders and in the cooperative as an organization was, in general, high.

What were the main reasons that certain cooperatives have been able to survive and how have they done it? It has turned out that leadership and the members' trust in leaders played key role in adjustment. Murray (2004) emphasizes that leaders and leadership may have a decisive role in improving and maintaining a high level of social capital. Relationships between leaders and members cannot be explained by economic arguments only. Working together and helping each other for years and to cease all these forms of mutual support would have demanded changes in human behavior which could not be accepted by the leaders of many cooperatives. Findings from both the experimental study and the cross-sectional survey by Cremer and van Knippenberg (2005) showed that self-sacrifice on the part of the leader has a positive effect on cooperation and, that perceptions of trust in the leader and feelings of collective identification mediated the effects of

this self-sacrifice. Focusing on different group aspects of leadership in social dilemmas, Vught (2002) concluded that the effectiveness of leaders' solutions to social dilemmas depends upon the correspondence between leader's characteristics and members' expectations.

Research findings

In this section, the historical development of two cooperatives will be discussed. It will be shown how social capital, after the destruction of the old distribution system, has been able to contribute to improving or maintaining cooperation.

The Béke Co-op was founded on June 27, 1955, by the poorest peasants in the town. The founders had a total of 73 ha of agricultural land. Both the number of co-op members and the area under cultivation increased significantly in 1960. Specialists came and worked for the co-op and huge investments were made over the years. Since 1967, farms have been interested in producing profits. Because of the enlarged size of production, the corporate governance of Béke Co-op was changed in 1978. In the following years, the co-op won an award of the "Cooperative of Excellence", several times.

During the transition to a market system, many agricultural cooperatives broke up and disappeared. In Béke Cooperative, the president was replaced by a new one in 1990 after 27 years of service. The new leadership decided to become offensive and distributed part of the land and assets among members and employees as permitted by law. At the same time, the president held face-to-face negotiations with all members. Finally, 64 out of 960 members (some 7 %) left the cooperative. This is below the national average.

Over the years, Béke has carried out a complete leverage buy-out of the Zelemér agricultural co-op. In addition, a turkey plant has been bought, two more beef and one pig production unit have also come into Béke ownership. Finally, the co-op merged with the Agro-Balmaz Agricultural Coop in 2000. Nearly 600 people work for the co-op in 26 different units running business cooperation with more than 100 entrepreneurs and cultivating a land area of 7,000 ha owned by 4,000 landowners.

Although the co-op has faced real challenges over the years, it has still managed to achieve significant economic growth and results. The cooperative has followed an expansive development policy by making new investments to become more stable but these have not always been tested by market needs and have required more and more loans.

Some 50 % of business shares in the cooperative were bought by the government in the late 1990s, which, under a new law on cooperatives passed in

December 2005, was given back to cooperatives, but can be used only under conditions of joint ownership.

The Hajdú Gazdák Agricultural Association was established at the beginning of the twentieth century but was suspended under the Communist regime. After 1990, individual farmers wanted to bring this association back into operation. First, the Farmers' Club was established in 1993 with the objective of representing the interests of the members, improving the skills of producers, increasing both the output and the quality of production. The Farmers' Club was succeeded by the Hajdú Purchasing and Marketing Cooperative (PMCH) in July 1996, focusing on gathering and spreading information, joint purchasing of inputs, and marketing of products. In 1999, PMCH decided to establish a new producers' organization called the Purchasing and Marketing Cooperative "HAJDÚ GAZDÁK" (PMCHG) to access additional government support. Justification for such an action was underlined by Murray (2004), saying "cooperation between people requires networks of association, and can be distinguished as situations where there is visible action on a collective level for a predetermined goal or social dilemma". Shortly after the establishment of PMCHG, the new and old co-op, with the same members, merged under the name PMCHG.

The cooperative is managed by the Board of Directors consisting of five members, supervised by a board of three members. The Members' Council meeting is the top-level decision-making body, with one member one vote. Payment for departing members is based on an equity ratio, and new members have to pay the same amount that departing members take out.

Visual Presentation of the actors, and their interactions

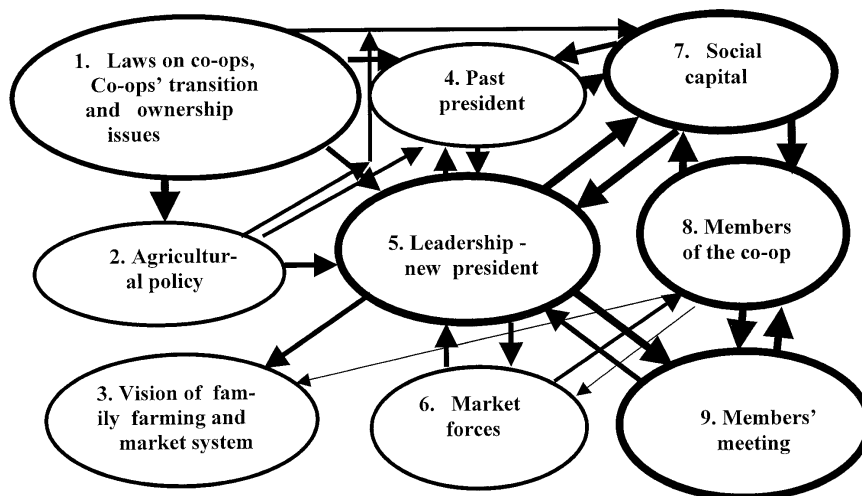
This section deals with actors from both case studies at the beginning of transition. The width of arrows in Figures 1 and 2 reflect the weight of a given link.

The Béke Cooperative – a traditional production cooperative

In 1990, a new president (director) was elected to the Béke cooperative. There was a high level of trust between the former and the new president and between them and most of the members. So the internal factors of social capital were at a high level and cooperative members did not want to break up the cooperative community that they had built up together over the years. Others mainly focused on the possible advantages of individual farming and somehow neglected the disadvantages. Relations and interactions between actors in the Béke Cooperative before the decision on transformation of the cooperative can be seen in Figure 1. Finally, only 7-8 % of members left. Government policy in the early nineties

encouraged family farming. Those who left cooperatives were sure they would be more successful as individual farmers. For them, some individual farmers in the region were regarded as successful pioneers. Their level of social capital was not high in relation to co-ops and co-op leaders.

Figure 1. Actors and their interactions in the Béke Cooperative before the decisions on future development.



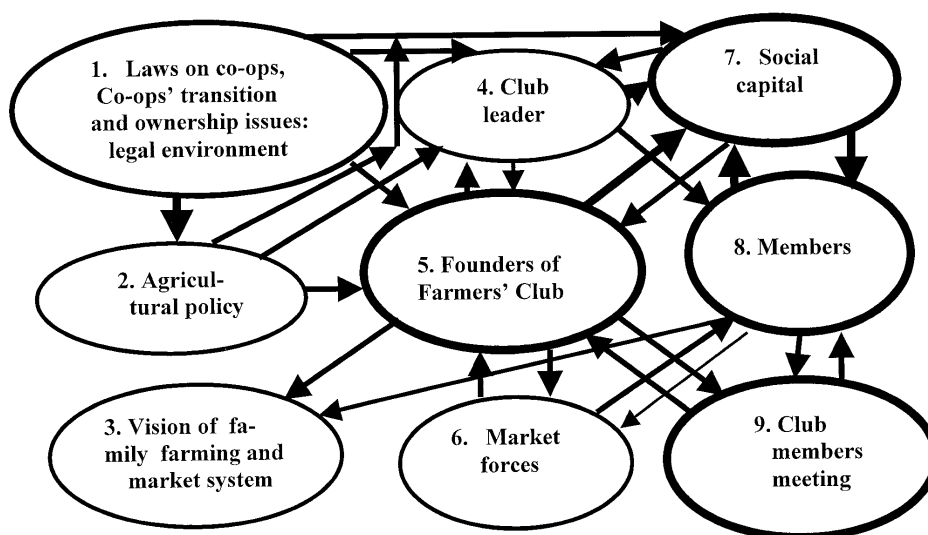
Béke cooperative had stable economic growth after radical reforms. Members had been satisfied, level of income from co-ops activities enabled people to provide acceptable standard of living for the family. Connections between members and, members and leaders are based on trust. Need for adjustment of co-op performance was realized and regarded as a job for leadership. Members followed co-op leaders, as they had known them for a long time. Investments or change in product structure proposed by leaders were accepted by ordinary members. Internal linkages between people in coop Béke can be seen in figure 1.

The Purchasing and Marketing Cooperative "Hajdú Gazdák" (PMCHG)

Concerning co-op PMCHG, the first step towards cooperation was when individuals established the Farmers' Club in 1993. Key players had strong influence in setting conditions for the further development of cooperation. The leader of PMCHG took only necessary administrative jobs but did not have such a strong influence on governance as the Béke president did. Social capital among

members was above average. Internally, part of this was connected with the founders having sufficient experience in family farming and former cooperative members being well informed about agricultural policy issues. Concerning external factors, members trusted very much in the new government and also in the institutional environment. Linkages and interactions between different actors in PMCHG can be seen in Figure 2.

Figure 2. Actors and the interactions between individual farmers before joining the Farmers' Club.



At the beginning of the nineties, social capital in general was somewhat stronger among Béke members than in the Farmers' Club, due to their history of successful collective achievements. However, in some areas the picture was the opposite. The previous president of the Béke cooperative had enjoyed a high level of trust among members. The atmosphere between leaders and members had been sufficiently good, and the legal environment had been transparent and stable. The level of trust in leaders remained high after the election of the new president in 1990. However, after radical reforms, trust in state institutions, in the legal environment, and in agricultural policy declined as the government favored family farms over cooperatives.

The Farmers' Club focused only on sharing information in the early stages of cooperation. Later on members raised the need to make joint purchasing inputs to reduce transaction costs and, later again, the need for joint marketing. At the end of the nineties the need for joint investment was raised and agreed on.

The role of trust/mistrust and opportunism

Social capital, trust, and cooperation involve people always looking at the possibility of working together in a smaller or larger community in order to benefit from such cooperation. Eight out of ten interviewees said they were not formal members of any local or regional group or association. One person from Béke was a member of the regional federation of cooperatives and one worked for local government.

Members of PMCHG emphasized explicitly the economic advantages of joining, as decreasing transaction costs. Thus sharing information gave an explicit benefit to them. The duration of personal relationships was an important factor but it was less significant than in the case of the Béke Coop. Relating to the benefits of trust, members emphasized the following: that people were helpful, that trust is the basis of common interests, that mutual trust is the greatest treasure, and that the benefits depend on the people themselves. Members of PMCHG said: *solving problems* raised by the group should be mainly managed by the cooperative rather than by national or local government agencies.

Members of the Béke coop found it important to mention that their parents were also members and that three of them had already been employees of the cooperative. For two of the respondents the town and the neighborhood meant their community, one defined the family and working colleagues as such, and one emphasized the importance of the whole county. Most of them had joined the cooperative many years previously. According to them, cooperation and integration had brought advantages to members. Others who joined later had been attracted by the cooperative's reputation. Although they were more cautious or more critical about trust, Béke members displayed a higher level of trust in EU institutions and in both national and local government officials. They also found mutual trust advantageous but stronger emphasis was given to more efficient work and a good working atmosphere. Béke members were more cautious, admitting that conflicts could come up everywhere, although it is not typical in the co-op. Economic problems should be solved by the national government, but the co-op must also do its best to solve problems. Members were more informed on historical aspects of farming and had information based on deeper analysis of economic issues in comparison with PMCHG members.

The reasons given for joining the cooperative were rather different in the two cases. In both co-ops, interviewees underlined the importance of the duration of personal relationships among members. Discussing trust in more general terms, members of PCMHG had higher levels of trust with business partners even without any documentation. Their levels of trust had changed based on their own experience gained over the years. Béke members were more pessimistic as a result of negative experience after 1990.

Members in both co-ops regarded trust and reciprocity as important element of social capital. However, their approach to the issue reflects different standpoints.

Trust towards formal institutions differed in the two co-ops. Members of PMCHG had low levels of trust in current government officials and EU institutions. In contrast, BÉKE members had more trust in national government their trust in EU institutions was also above average. However, where trust levels in state institutions were low, to reduce transaction costs people looked for informal institutions to solve their problems.

The role of communication and information

People in communities always change their views on different issues based on information gained through different communication channels. How intensively these channels are used affects the level of social capital.

To access information on government and EU issues members of PMCHG tried to find more channels to gain information and used them more frequently, while Béke members mostly relied on national media but less on local community leaders. Information from cooperative leaders was backed up by obtaining and analyzing information from various governmental and other sources of information. Collecting information on community issues was done rather differently in both groups. The frequency with which information was gathered was significantly lower in Béke. All PCMHG members got information mainly from community leaders as well as from community and local newspapers.

The extent to which people were satisfied with the information they had was a key point. Based on the Ostrom approach (cited in Murray, 2007) that during the communication process social capital is enhanced or eroded through the establishment of trust, reputation and reciprocity, we can see a positive outcome in both co-ops as the general picture was excellent. PMCHG members found decisions on investments to be a weak point in communication. Blockage or withholding of information within the cooperative was not indicated as a serious problem. The high level of satisfaction with the supply of necessary information was supported by the fact that in both co-ops there was a continuous discussion

among members on important business issues. The dialogue is quite intensive and new information is shared as soon as possible. PMCHG members were more optimistic concerning members' capacity for problem-solving.

As regards external contacts with relevant people from similar organizations, members in both co-ops thought that such tasks were mostly the job of leaders. It is true that external relationships are not very strong in either case.

People emphasized that, whether working for the cooperative for a shorter or a longer period, one always gains something from it. The members of the younger cooperative put a high value on joint efforts and collective action while members of Béke indicated the value of being well informed. All ten interviewees said they were satisfied with the information they had been provided. When not, then additional efforts made had proved sufficient to acquire the missing information. In both cases, people have used different channels at different intensities to obtain sufficient information. Communication has not been used as a source of power by central actors, but as a bridge through which more help could be given to members.

Transaction costs and governance structure

PMCHG members regarded as most important the incentives (economy, environmental protection) which most affected transaction costs and, to reduce transaction costs, they were willing to cooperate and open to extending cooperation with non-members. To reduce transaction costs, Béke members appreciated very much the historical background of relationships and education. Most of the interviewees had not calculated any costs of attending internal meeting but more of them calculated costs related to attending external meetings.

Membership was seen as a benefit, especially in the PMCHG co-op. The benefits they indicated included market access, the reduction of input costs, joint use of machinery, and getting farm gate prices based on quality. In the case of Béke, people listed those benefits which they had had for years but were at risk of losing. To improve efficiency and enhance cooperation, Béke changed its governance structure in the late seventies.

PMCHG changed its governance structure in 1996 as well as in 1999 in order to reduce transaction costs or to become eligible for additional resources and to improve cooperation. It was evident that cooperatives, in order to reduce transaction costs, have decided to change governance structure and have adjusted to new economic conditions and market situations.

The role of the State and formal institutional environment in cooperation

Members of both cooperatives agreed that cooperatives were efficient and in good economic shape in socialist times. Besides the coming into force of a new economic mechanism in 1967, there were two more factors which improved cooperation. First, cooperatives were allowed to engage in so-called non-agricultural activities (for example construction work, producing spare parts) which produced more profits than animal husbandry or crop production. Taking advantage of subsidization policy, they developed the infrastructure on the farms, bought the latest technology and new machines, produced more profits, and paid more to members and employees. Secondly, cooperatives could do the latter because farm gate prices gradually increased to approaching market prices. Agriculture achieved a high growth rate in the first half of the seventies and a still reasonable level in the second half of the decade, but growth slowed down thereafter. An experiment showed that if co-ops got more freedom they would be able to increase efficiency and to generate more profits.

People's attitude towards cooperation has changed significantly since the introduction of radical reforms. Mainstream views have become more negative, making people more reserved and less likely to engage in cooperative activity. Compensation on land was not well prepared and managed. The level of trust among people has declined and members were cautious when asked about additional steps in cooperation.

The majority of responses made clear that trust towards central and local government has deteriorated. This decline was more pronounced among PMCHG members and only one person out of ten responded that trust in government had increased since the beginning of the transition period. It was also mentioned that the declining level of trust was due to the ruling government.

Members of the Béke Co-op have been mostly unsatisfied with the performance of the state while PMCHG members were more positive. In general, people were disappointed with the agricultural policy preparations for EU membership. After the introduction of a new economic mechanism in agriculture in 1967, social capital started to increase and developed as the economic environment became a mixture of a centrally-planned and a market economy. Social capital was not low in Hungary during the seventies and eighties.

Communities, Social networks and Informal institutions

The motivation of helping the community has been strong in both co-ops, even if only other members of the local community could benefit from it. The general attitude of cooperative members has been highly community-oriented. People feel motivated to help if this involvement is only giving their time. If, in addition, money was required for community development, fewer people were ready to contribute. All PMCHG members interviewed were willing to sacrifice more and would be willing even to pay money as well. Members of the Béke co-op were also in favor of improving cooperation but they expected to get direct benefits if a financial contribution were required. The majority of PMCHG members mentioned that conflicts should be openly discussed within their group. For major issues the cooperative's by-laws must be used. Béke members said that both formalized and informal mechanisms could be used to find solutions to disputes. On recognizing a problem, people in both co-ops would take action to clarify it with the initiator (Béke) or to address it to the cooperative leader or have a meeting for the entire group (PMCHG). Thus, elements of Bowles and Gintis' (2002) community governance were evident. People in PMCHG did not perceive a clique to exist in the group. In the case of Béke, two members mentioned that such cliques existed.

Cooperation is affected by several factors. All nine members who responded underlined the factor of keeping well informed, and having sufficient information to make decisions as being most important. Besides that, a high level of trust and market-driven incentives for cooperation were also mentioned. It can be concluded that informal institutions were not seen as a necessary determinant for achieving cooperation. People could efficiently make use of formal institutions and only very seldom tried to find solutions by informal means.

The role of the market in fostering/hindering cooperation

Members of PMCHG took a practical approach, saying that agriculture is sustainable until it is profitable. Most interviewees from the Béke co-op also thought agriculture could not be sustainable because of lack of profitability. Sustainability much depends on subsidies available for the sector. Concerning environment-friendly agriculture, people found different areas worth underlining, but organic farming was the leading one.

The competitiveness of the cooperative was evaluated at different levels. In the case of PMCHG, one member found the cooperative competitive, two thought the co-op was moderately competitive, and two people gave no answer. People from the Béke co-op used the argument that, as the cooperative had been operating for

50 years, it should be competitive. It was also added that, nowadays, neither the co-op's foreign nor its domestic market could be regarded as stable. Tourism was not seen as an activity which might be a solution to regional or local problems. People found market forces important and underlined the need for cooperation to become competitive, and to meet market requirements.

Conclusions

People in both cooperatives have had different experiences since the end of the socialist era and have followed different paths of development since the introduction of radical reforms.

Members of the PMCHG cooperative started to increase cooperation, with the benefit of experience gained from individual farming and justified their actions according to a reduction in transaction costs. Members of the Béke co-op achieved successful development from the mid-sixties to the late eighties; they strongly believed in cooperation and had a high level of trust in their leader going back many years. In the case of both co-ops, it turned out that a high level of trust is an effective way of reducing transaction costs, even where this level of trust is based only on one's own or on their parents' experience. The latter was a stronger factor for members of the Béke co-op and indicates that co-op members had high levels of social capital under the socialist system.

The role of leadership was partly different in the two cooperatives. In the Béke co-op, the major goal of leaders was to avoid breaking up the cooperative community, while at PMCHG the main job for key persons was to persuade individual farmers to start and deepen cooperation in order to build up a new cooperative community. Trusts in leaders of both co-ops indicated that leadership plays an important role in cooperatives.

Based on different experiences from history, trust towards formal institutions differs in the two co-ops. It was justified that the level of communication affects the level of cooperation. The latter has not been handicapped by a shortage of information in either co-op and communication has not been used as a source of power by central actors in either co-op. In order to reduce transaction costs, changes in governance structures took place in both co-ops.

People could find their own way of solving problems relying on formal institutions. However, if the latter did not work, they used informal institutions. For members of the PMCHG co-op, informal methods played a more important role at the very beginning of cooperation.

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