RURAL PARTNERSHIP AS A GOVERNANCE MECHANISM: TOWARD AN ORGANIZATIONAL ECONOMICS PERSPECTIVE ON RURAL GOVERNANCE*

Vladislav Valentinov**

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ABSTRACT

The paper develops an organizational economics approach to explaining rural governance by viewing rural partnerships as a governance mechanism that can be used for organization of rural development activities along with markets and hierarchies. Utilizing the framework of the property rights theory of the firm and transaction cost economics, it is argued that rural partnerships exhibit superior transaction cost-economizing attributes due to their ability to accommodate high commonality of interests of local actors in the sustainable development of their rural areas. This argumentation is based on the proposition to regard the commonality of transaction participants' interests, rather than transaction attributes, as a major determinant of suitability of governance mechanisms to specific transactions. The paper concludes with the discussion of limitations of partnership-based governance.

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** Research Associate, Institute of Agricultural Development in Central and Eastern Europe.

I. Introduction

In the recent years, the literature on rural development has been marked by growing attention to the issues of rural governance. The rural governance agenda has emerged in the context of the shift 'from government to governance' (Marsden and Murdoch 1998, 1) and signified 'a change in the meaning of government, referring to a new process of governing; or a changed condition of ordered rule; or the new method by which society is governed' (Rhodes 1996, 652-3, quoted in: Stoker 1998, 17). As proposed by Stoker (1997, 10), 'governance is about governmental and non-governmental organizations working together. Its concern is with how the challenge of collective action is met and the issues and tensions associated with this shift in the pattern of governing'. The key aspect of rural governance has been the increasing reliance on partnerships beyond the formal structures of government, as has been articulated in the Cork Declaration and the conclusions of Second European Conference on Rural Development in Salzburg.

The concept of rural partnership has been enjoying increasing political popularity and scholarly research. On the political side, rural partnerships have been actively supported by a number of national and European policy initiatives, with the most prominent example of the latter undoubtedly being the LEADER program. On the research side, a great number of empirical studies have documented the important positive impact of partnerships on creation of jobs in rural areas, support of existing and founding of new rural enterprises, provision of services, as well as capacity building, community involvement, innovation, and better coordination of development initiatives (see e.g. Moseley 2003: xxii, and references therein).

However, although the practical impact of partnerships has come to be widely recognized, the mechanism of their operation has still not been sufficiently understood at a theoretical level. Indeed, partnership issues have been referred to as 'black-boxed' within considerations of governance (Jones and Little 2000, 172). In the same vein, a 2001 OECD survey of local partnerships emphasized that though their inputs and outputs are visible, the mechanisms enabling the transformation from inputs to outputs remain unclear. This essay will seek to contribute to a theoretical understanding of these mechanisms by adopting an institutional, and more specifically, organizational economics approach, with its fundamental focus on comparative institutional analysis. In particular, rural partnerships will be rationalized here as a governance mechanism enabling the most efficient implementation of rural development activities in comparison with its major institutional alternatives, such as market and hierarchy. The key research questions driving this theoretical enquiry are the following: how can rural partnership be conceptually positioned with respect to its institutional alternatives? What criteria may be used to compare their efficiency? How can it be demonstrated that partnerships can be more efficient for specific rural development tasks?

Moreover, approaching the rural development issues from an organizational economics perspective can serve to deepen the understanding of the essence of partnership-based governance which, under the heading of 'hybrid governance', constitutes one of central concepts in the modern organizational economics literature (see e.g. Menard 2004). In the most of this literature, hybrid governance mechanisms are believed to represent a mixture of organizational attributes of markets and hierarchies and to be in this sense located between these polar forms, if the diversity of possible governance mechanisms is imagined in the form of a continuum. However, the hybrid nature of such governance mechanisms as partnerships may be subject to dispute, as partnerships have substantial differences from both markets and hierarchies and possibly represent an independent mechanism, which is defined not by the mixture of market and hierarchy attributes, but rather by its own logic. The crucial questions here are: Wherein does this own logic reside? How can it be compared to the logic of markets and hierarchies? Is it possible to construct an alternative governance continuum which would not lend itself to similar criticisms? As will be shown below, the context of rural development is particularly helpful for dealing with these questions.

Therefore, the argumentation offered in the paper will be, on the one hand, inspired by and consistent with the general logic of organizational economics theory, and on the other, it will be critical of the conventional understanding of hybrid governance which seems to be dominating the relevant literature. Thus, in the tradition of organizational economics, it will be shown that such governance mechanisms as partnerships allow to realize the rural development activities with lower transaction costs as compared to markets and hierarchies; however the heuristic method by which these transaction costs are identified here will reflect the understanding of partnerships which goes beyond the mere recognition of their ‘hybridity’.

In line with this, the paper will proceed as follows. Section II sketches out the general understanding of governance mechanisms in organizational economics and identify an alternative view of the governance continuum. Section III discusses how and in what cases partnership-based governance exhibits superior transaction cost economizing properties. Section IV demonstrates that partnerships, while economizing some transaction costs, may generate other, giving rise to the paradoxes of partnership-based governance. Section V contains concluding remarks.

Ⅱ. Governance mechanisms in organizational economics

1. Conventional view

The interest of economists to the issues of organization of economic activity has been, in a general sense, awakened by seminal insights of Coase (1937), who argued that whether a particular transaction is organized within a firm or through the market depends on the relative costs of these alternative modes of organization. Since then, the organizational economics literature has further extended and enriched the understanding of the significance of alternative forms of business organization for economic performance. Within this literature, the explicit focus on comparative institutional analysis at the enterprise level has been particularly characteristic for transaction cost economics (e.g. Williamson 1975; 1985; 1996) and the property rights theory of the firm (Grossman and Hart 1986; Hart and Moore 1990; Hart 1995).

The main hypothesis of transaction cost economics states that 'transactions, which differ in their attributes, are assigned to governance structures, which differ in their costs and competencies, in a discriminating—mainly transaction cost economizing—way, whereby the principal dimensions of transactions include asset specificity, the frequency with which transactions occur, and the degree and type of uncertainty to which they are subject (Williamson 1996, 59). The transaction cost economics argues that transactions characterized by high frequency and uncertainty and involving highly specific assets are most efficiently governed within hierarchical organizations; for transactions of the opposite type, market governance is most efficient; for transactions exhibiting intermediate values of these dimensions, transaction costs are minimized by hybrid governance, which may take the form of partnerships, long-term contracting, alliances, joint ventures, networks, franchising, cooperatives, etc.

According to Williamson (ibid), markets, hierarchies and hybrids differ from each other in terms of the following attributes: 1) the type of economic adaptation they support; 2) incentive intensity; 3) reliance on administrative controls. Regarding the first attribute, markets are efficient in that kind of adaptation for which 'prices serve as sufficient statistics', i.e., allow rapid responses to changes in relative prices. Hierarchies are efficient for the adaptation involving bilateral dependency of transactors and requiring coordinated action. Under conditions of bilateral dependency, reliance on prices alone will lead to suboptimization represented by e.g. working at cross-purposes and strategic behaviour. Respectively, the use of hierarchical governance is suboptimal (i.e., causes relatively high transaction costs) for the situation when no bilateral dependency is involved. This can be explained by invoking the second mentioned attribute of governance mechanisms: incentive intensity. In comparison to market, hierarchical governance presupposes a looser connection between effort and remuneration, which dampens the incentives of actors occupying subordinate positions in a hierarchy to put resources to the most efficient use. In this way, hierarchy generates slack. Finally, the third attribute—reliance on administrative controls—represents a fundamental characteristic of hierarchy, is practically not relevant for market, and exhibits intermediate relevance for hybrids. Indeed, with regard to these three attributes, hybrids are really located somewhere between markets and hierarchies, which has been argued by theorists proposing the concept of continuum of governance mechanisms (Williamson 1991; Mahoney 1992; Peterson et al. 2001; Menard 2004).

2. Toward a new conceptualisation of the governance continuum

The problem with this representation of the continuum is that it does not allow for any independent logic of hybrid organization, as distinct from that of markets and hierarchies. Whereas market is coordinated by prices and hierarchy—by authority relation, hybrids are thereby supposed to rely on certain combination of these two coordination mechanisms. This view of hybrid organization, however, appears problematic for partnership-based structures, and specifically rural partnerships, for the reason that the coordination among members of partnerships is based neither on prices nor on authority relation. Indeed, the fact that partnerships exist to promote common interests of members has two consequences: 1) cooperation among members represents a form of collective action rather price-mediated transactions between them; 2) if the underlying interests are truly common, i.e., if partnerships' members have equal stakes in the performance of their partnerships, then there are no grounds to subordination of some members to others.

To further substantiate these two consequences, let it be mentioned that, in fact, rejection of both prices and authority relation as coordination instruments is a defining characteristic of any bottom-up organization. Members of such organizations, by definition, do not need to engage in price-mediated transactions with each other, since if it had been otherwise, then market organization would be sufficient to effect the needed coordination, thereby making bottom-up organization itself redundant.[2] Again, bottom-up organization is by definition voluntary, which stands in a clear contrast to hierarchy presupposing subordination of lower−ranking members to higher−ranking ones. Therefore, inasmuch as rural partnerships represent bottom-up organizations, they cannot be regarded as a mixture, or hybrid, of markets and hierarchies. Consequently, understood in this way, rural partnerships do not fit into the conventional view of governance continuum, presupposing that all governance mechanisms contained within it rely on at least one of the two basic coordination instruments-prices and authority relation.[3]

This conclusion, however, poses a new problem: is partnerships are not part of this continuum, how is it possible to conceptualize the logical relationship between market, hierarchy, and partnership-based organization? Is it possible to identify other criteria that would allow to establish logical links between all of these governance mechanisms? In itself, the continuum view of governance is valuable because it gives a clear understanding of the criteria determining which governance mechanisms are most efficient in particular situations. That is, merely to state that rural

2 The rejection of price-mediated transactions here relates to the activities of the bottom-up organization in question. It is possible that outside this organization, their members may be involved in trade with each other.

3 It should be kept in mind that this argumentation does not relate to all hybrids, but only to those which presupposepooling of resources and efforts to achieve common objectives. Rural partnerships represent typical examples of such hybrids. On the other hand, there certainly exist other governance mechanisms which do rely on both prices and authority relation as coordination instruments, such as e.g. various forms of vertical coordination in agribusiness. Such coordination mechanisms should not be confused with partnerships.

partnerships do not fit into the conventional continuum does not explain why partnerships can be more efficient than markets and hierarchies (rather, the conventional continuum view is geared to explaining why hierarchies can be more efficient than markets and vice versa, but that is not relevant for partnerships). Therefore, in order to provide an economic rationale for the shift 'from government to governance', or, in organizational economic vocabulary, from hierarchical to partnership-based governance, an alternative view of the governance continuum is required. This alternative view should, on the one hand, accommodate market, hierarchical, and partnership-based organization, and on the other, recognize the existence of the independent logic of partnerships rather than treat them as a mixture of markets and hierarchies.

This essay advocates the view that the criterion whereupon such an extended alternative continuum can be built is represented by the extent of common interest shared by the participants of respective governance mechanisms. The extent of common interest is understood here as the extent to which the objectives of these participants are overlapping. Though in somewhat schematic terms, it can be argued that markets, hierarchies, and partnership-based mechanisms exhibit successively growing reliance on common interests uniting their respective participants.

Specifically, markets are based on a known antagonism of interests of buyers and sellers, since resources received by the former represent resources taken away from the latter and vice versa. Moreover, given that market is competitively organized, there is little interdependency in the levels of wellbeing of individual buyers and sellers, in the sense that, if a particular buyer or seller fails to perform his economic function, their respective partners will not suffer too much because alternative buyers and sellers can be found.[4] In the case of hierarchy,

[4] Minimal reliance on common interests should not, however, be interpreted as the absence of such interests. Both parties to the transaction may have common interests in maintaining the regime of property rights in which they operate or developing an effective trading infrastructure.

however, the antagonism between the interests of super- and subordinates is less pronounced than in markets; rather it is more justified to speak about agency relationships and the associated divergences of interests of agents and principals than of a polar constellation of their interests. There also exists a certain interdependency between the levels of wellbeing of super-and subordinates, in the sense that all of them belong to one organization; if this organization performs poorly, that will affect the well-being of all involved participants (although some participants, according to their position in a hierarchy, will be affected less than others). Partnership-based structures, evidently, exhibit maximal reliance on common interests. Indeed, promotion of common interests represents the basic objective of these organizations. The interdependency in the levels of wellbeing of partners is significant in the sense that if their partnership performs poorly, this will have equal adverse effects for all partners.

Now that the extended view of the governance continuum, incorporating all three basic governance mechanisms (i.e., from markets through hierarchies to partnerships), is available, it is possible to start looking for regularities which determine the relative efficiency of these mechanisms in particular situations—in the present case, not only compare markets with hierarchies, but also compare markets and hierarchies with partnership—based governance. Given the existence of common interest of interacting agents as the underlying criterion of the new continuum, the problem of economic organization can be conceptualized as ensuring that the extent of common interest characteristic for actual economic interaction is adequately reflected in the extent of common interest foreseen by the adopted governance mechanism. To take a standard case of transaction cost theory, such attributes of transactions as high asset specificity, high frequency and high uncertainty all serve to increase the actually existing extent of common interest between the transacting parties. If such transactions are governed by market mechanism which is adapted for situations when the interests of transacting parties are more or less antagonistic, efficiency losses will result (e.g., value-enhancing relationship-specific investments will be replaced by generic ones). Conversely, if transaction involving only limited common interest between the transacting parties is governed by hierarchical mechanism presupposing greater reliance on common interests, this will generate extra bureaucratic costs and organizational slack. On the whole, the argumentation regarding relative efficiency and transaction cost economizing attributes of markets and hierarchies is well developed in the literature. But the question that needs to be addressed here relates to partnerships rather than markets and hierarchies: how can partnerships economize on transaction costs as compared to markets and hierarchies? How can transaction costs, economized by partnerships, be understood?

These questions are crucial and theoretically relevant for the reason that the familiar argumentation about asset specificity, transaction frequency and uncertainty is evidently not applicable to activities undertaken by partnerships, particularly rural partnerships. Evidently, cooperation between local government officials, farmers, rural communities, entrepreneurs, and other possible participants of local action groups may not involve any assets that may be meaningfully characterized by the degree of their specificity; frequency and uncertainty of interaction are also not necessarily the relevant determinants of whether this interaction should be governed hierarchically or on bottom-up basis. Arguably, the standard transaction cost theory is most appropriate for comparisons between markets, hierarchies, and 'truly hybrid' governance mechanisms that do use both prices and authority relation as coordination instruments; for these comparisons, asset specificity, frequency, and uncertainty do represent the relevant transaction attributes. However, as far as activities of partnerships are concerned, the relevant transactions are of a much different kind; they may include e.g. building a local school or a hotel, or founding new rural businesses. Consequently, for such transactions, other criteria are required to enable meaningful comparisons between alternative governance mechanisms. As follows from the above developed argumentation, the criterion that will be used for this purpose is represented by the extent of commonality of interests existing among those actors who implement such transactions.

This implies that transaction costs economized by partnerships are of a different kind than those economized by markets and hierarchies in regular business transactions. The following section will present a possible approach to understanding the ‘partnership-specific’ transaction costs. This approach will be based on the property rights theory of the firm analyzing the efficiency implications of vertical integration; the arguments of this theory will be modified and extended to be applicable to the case of jointly undertaken activities exhibiting some important extents of the existence of common interests among those who implement them. However, the general logic of comparative institutional analysis as characteristic for organizational economics will be maintained: it will be assumed that 1) efficiency of governance mechanisms is determined by their relative capacity to economize on transaction costs; 2) transaction costs result from the inconsistency between the actual extent of common interest in a particular activity and its extent presupposed by governance mechanisms actually employed.

Ⅲ. Identifying the transaction cost-economizing role of partnerships

1. Setting the framework for argumentation: the property rights theory of the firm

Mahoney (2004) differentiates between the classical theory of property rights which deals with comparison between efficiency implications of alternative property rights regimes as well as emergence and evolution of property rights and the modern theory studying the optimal allocation of private property rights. It is the modern theory, also designated in the literature as the property rights theory of the firm, that will inform the proposed here analysis of partnership-based governance. This theory posits that it is too costly and therefore impossible to write comprehensive contracts. Contracts that are actually written are necessarily incomplete, in the sense that they contain gaps, missing provisions, and ambiguities. Ownership matters because it is a source of power to decide about the uses of assets in situations not foreseen in the contracts.

According to the property rights theory of the firm, there is a major cost of contractual incompleteness that can be reduced by efficient allocation of private property rights (specifically, residual claims): since each party to the contract fears to be ‘held up’ by its partner, they will be deterred from making relationship-specific investments that would be optimal in a first-best world (Hart 1995, 26). The substitution of relationship-specific investments by generic ones means foregoing the efficiency benefits of specialization in order to obtain more security (ibid, 27). Here, the property rights theory argues that the undertaking of relationship-specific investments can be facilitated if the party which has to make an important investment decision receives sufficient property rights in the assets of the other party to the contract (i.e., vertically integrates), since in this case the other party can no longer behave opportunistically. Therefore, efficient assignment of property rights performs the function of enabling the undertaking of relationship-specific investments.

However, the property rights theory of the firm recognizes not only benefits but also costs of ownership. Analyzing the case of vertical integration by means of acquisition, Hart (ibid, 33) notes that 'the benefit of integration is that the acquiring firm's incentive to make relationship-specific investments increases since, given that it has more residual control rights, it will receive a greater fraction of the ex post surplus created by such investments. On the other hand, the cost of integration is that the acquired firm’s incentive to make relationship-specific investments decreases since, given that it has fewer residual control rights, it will receive a smaller fraction of the incremental ex post surplus created by its own investments’. A major insight from this theory is that the willingness to make relationship-specific investments can be either increased or decreased depending on the relative distribution of property rights between parties to the contract.

What does this have to say about partnerships, and specifically, rural partnerships? The conceptual link can be seen in the following: just like parties to the contract think about the expediency of making relationship-specific investments, individual stakeholders with an interest in some rural development activity think about making contributions to support this activity; just like the decision to make an investment depends on the existence and relative distribution of property rights, the decision to make a contribution to a rural development activity can be determined by the relative role of stakeholders in the governance of this activity. Generally, just like the firm is seen in the property rights theory as an institution designed to maximize relationship-specific investments, rural partnerships can be considered as a comparable institution designed to maximize resource contributions to (i.e., mobilize resources for) rural development activities.

2. The relationship between stakeholders' property rights and efficiency of governance

One of the major conclusions of the property rights theory of the firm is that 'a party is more likely to own an asset if he or she has an important investment decision' concerning this asset (Hart 1995, 49; Grossman and Hart 1986, 716-717). Thereby, the theory introduces the important idea that efficient resource allocation is possible only when the economic interests of the parties to the contract are consistent with their property rights following from the type of governance structure that they use. To explore the implications of this idea for rural partnerships, the argumentation regarding the relative importance of investment decisions can be extended in the following way: whereas the property rights theory focuses basically on the identification of the more important investment decision, one can additionally take into account the actual importance of the investment decisions of the other party to the contract. Although the investment decision of the other party is by definition less important, the extent of its actual importance has a number of implications for the choice of optimal governance mechanisms.

To demonstrate this, consider two firms A and B, the first of which organizes the production of certain products and for this purpose needs to buy certain inputs from the second one. Assume that these inputs are fungible and firm A can easily either find alternative suppliers or substitute these inputs by other similar inputs. In this case, it is obvious that firm A has much more important investment decisions to make (with respect to the production in question) than firm B. However, given the fungibility of the inputs that need to be purchased by firm A, the appropriate governance structure for this purchasing transaction is represented by market rather than hierarchy, as could follow from a superficial application of the logic of the property rights theory of the firm. Indeed, the argument of this theory, that the difference in relative importance of investment decisions of the parties leads to superior efficiency of hierarchical governance, applies only to the case when the inputs are assumed to be not fungible, and firm A is assumed to be unable to easily switch to alternative suppliers (see Hart 1995, 25-26).

Now, consider the case when the investment decisions of both firms are equally important. In this case, both firms have equal interests in the corresponding transaction, and therefore will seek equal decision making rights in the governance of this transaction and respectively equal rent sharing. When equal participation of this kind is required, both market and hierarchical governance are not adequate, since they presuppose more decision making power for firm A than for firm B. Indeed, if firm A purchases inputs from firm B or acquires firm B itself (i.e., vertically integrates), firm B's managers have little discretion over the organization of production (and utilization of firm B’s outputs) in firm A. Put differently, if the interests of both firms in a particular transaction are essentially equal, both market and hierarchical governance would cause over-representation of the interests of one party at the expense of the interests of another party. This over-representation takes the form of unequal distribution of decision making powers and consequently unequal distribution of rents from cooperation. This would reduce the motivation of the disadvantaged party to engage in this transaction, even though this transaction appears efficient from the allocative point of view (given fair rent sharing). The governance mechanism that allows the needed equal participation in the decision making and consequently fair rent sharing is represented by some form of cooperative agreement, possibly represented by network, association, alliance, or cooperative.

This argumentation suggests that the efficiency of governance is determined by the degree of consistence between the relative importance of investment decisions of the parties to the contract, on the one hand, and their property rights (i.e., rent shares and decision making powers[5]), on the other. Specifically, the governance can be defined as efficient if the party with a relatively important investment decision has privileged property rights, i.e. is either a buyer of inputs (if they are fungible) or an owner of the firm producing these inputs (if they are specific)[6]. To remind, in the present argumentation the privilege means the power to decide upon the way of utilization of the inputs and to appropriate rents emerging from this utilization. Respectively, the governance can be defined as inefficient if the relative importance of investment decisions of the parties is not properly reflected in the property rights assigned to these parties within the adopted governance mechanism.

Depending on the particular type of inconsistence between the relative importance of investment decisions and property

[5] This is the meaning in which the term 'property rights' will beused further in the text, unless stated otherwise. In this understanding, property rights define the relative position of parties within a particular governance mechanism. As mentioned in the text, these rights specify rent shares and decision making powers.

[6] Here it is again assumed that inputs with intermediate degrees of specificity are efficiently supplied within the framework of respective forms of hybrid governance.

rights, two interrelated inefficiencies can be identified. First, if a party has relatively extensive property rights but relatively unimportant investment decisions, it will tend to dissipate the possible rents from cooperation. This may happen in two forms: 1) if this party can use its property rights to appropriate disproportionately large share of rents, this will discourage the other party which has a more important investment decision, to actually make this investment; 2) if this party cannot appropriate the larger share of rents, for this very reason it will not be motivated to utilize the resources, over which it has command, in accordance with their marginal productivity. The second inefficiency of wrong governance is the inverse of the former: if a party has an important investment decision to make, but its property rights are too constrained, then the respective investment will be crowded out, for the reason that the gains from this investment cannot be adequately appropriated. Consequently, wrong governance presupposes dissipation of scarce resources on the part of the advantaged party and crowding out of investments on the part of the other party.

These two governance inefficiencies−crowding out effect and dissipation effect−are evidently related to the concept of costs of ownership mentioned in the previous section, namely attenuation of incentives to make relationship-specific investments on the part of the acquired firm. Generally, the existence of costs of ownership by itself does not mean that governance must be inefficient, as efficiency is determined by optimality of allocation of these costs across parties to the contract, according to the relative importance of their investment decisions. Inefficiency emerges only when the relative importance of investment decisions is not adequately reflected in the distribution of property rights in the governance of the transaction in question.

3. Implications for rural partnerships

The possibility of crowding out and dissipation effects suggests an explanation why it is efficient to organize the pursuance of common interests without recourse to both price-based and authority-based coordination, as is characteristic for partnerships. Specifically, both price-based and authority-based coordination presuppose an unequal distribution of property rights in the governance of relevant transactions; given the equality of stakeholder interests, it may be expected that the stakeholders with privileged property rights (buyers or hierarchical supervisors) will dissipate part of resources that they could have contributed to the transaction, whereas the stakeholders with relatively insignificant property rights (respectively sellers or hierarchical subordinates) will abstain from contributing some resources that could have been contributed otherwise. This is so because both sellers and hierarchical subordinates will tend to regard their duties as 'fulfilled' after their work has been positively accepted by those who placed the respective order, either in the form of a market contract or an administrative instruction. Respectively, buyers and hierarchical superordinates will assume more or less one-sided responsibility for further utilization of this work after it has been successfully delivered. This is clearly inefficient if all the involved parties have equal interests in this work, which therefore requires their continuous and equal-footed cooperation.

This argumentation readily lends itself to recasting in transaction cost economizing terms. Just like in standard transaction cost theory, transactions characterized by significant actually existing common interests (due to e.g. high asset specificity) generate high transaction costs if governed by mechanisms presupposing relatively small role for common interest (e.g. arms-length contracting), both market and hierarchical governance will similarly be associated with high transaction costs when applied to transactions exhibiting particularly high degrees of commonality of underlying interests. Whereas in standard transaction cost theory, high transaction costs may cause foregoing the efficiency benefits of specialization in order to obtain more security (Hart 1995, 27), in this context they mean failure to use resources according to their marginal productivities (in the form of under- and overinvestment by different stakeholders). Accordingly, the use of partnership-based governance to organize such transactions displays superior transaction cost economizing characteristics.

It is relatively clear what is implied by the application of hierarchical governance to transactions and activities related to rural development—it is the disproportionate shift of formal responsibility and power to decide on these issues toward governmental bodies. The meaning of market governance in the rural development context deserves however some further clarification. Market governance presupposes price-mediated transactions among the transacting parties; and price, as is known, is composed of cost and profit components. Price-mediated transactions therefore imply that some parties are making profits on other parties. This is clearly inconsistent with the nature of partnership-based governance. Even in business partnerships (alliances, associations, networks, cooperatives, etc.) partners are not supposed to make profits at the expense of each other, but rather to pool efforts in order to exploit their synergies. Also in rural partnerships and local action groups, equal distribution of property rights means that no stakeholder is entitled to earning profits at the expense of other stakeholders. Moreover, rural partnership as a whole pursues objectives clearly different from earning and maximizing profits. Indeed, in the governance and profit orientation respects rural partnerships are similar to nonprofit or third sector organizations characterized by the following features: private character (i.e., not part of government), prohibition of profit distribution, self-governance, and voluntary membership (Salamon and Anheier 1992).

The transaction cost theory has emphasized the crucial role of transaction costs in determining the size of business firms (Coase 1937; Demsetz 1988; Williamson 1985). If the size of rural partnerships is defined by the extent of engagement of their stakeholders (e.g. in terms of resources contributed by them), the transaction cost economizing characteristics of such partnerships do exercise an influence over how large they can grow. Arguably, the maximal possible extent of stakeholder engagement is determined by two factors: the marginal valuation of the value of particular rural development activities by these stakeholders, and their total resource budgets (including time resources). If transaction costs were zero, the actual extent of engagement would be equal to this maximal extent. When transaction costs are positive, the actual extent of engagement falls short of the maximally possible one, with the gap between them being indicative of the size of those costs.

Coase (1937) argued that an increase in transaction costs, which he understood as the costs of using the price system, would cause an increase in the size of firms. This view has been criticized by Demsetz (1988) who stated that an increase in transaction costs would complicate the exchange processes and therefore lead to a move away from specialization toward a greater reliance on self-sufficiency, which means shifting of productive activities from firms to self-sufficient autarkic units. The view of the effect of transaction costs on the size of rural partnerships expressed here lies evidently in the Demsetzian tradition, since the relevant transaction costs serve to constrain, rather than to expand, the scope of such partnerships. Accordingly, these partnerships can be believed to find themselves in a state of dynamic equilibrium: whereas transaction costs tend to reduce their size, they try, by means of their ingenious governance features, to reduce the size of transaction costs.

Ⅳ. Paradoxes of partnership-based governance

One of comprehensive empirical investigations of rural partnerships across Europe has discovered that the most commonly reported strength of these organizations is their ability to mobilize local human capital—skilled local actors willing to cooperate and work for the common good (Moseley 2003, xviii). As has been established above, this occurs due to the ability of partnerships to offer a regime of property rights which is conducive to the realization of common interests. However, at the same time it is recognized that partnerships do not represent a panacea for rural development (OECD 1990: 13). Indeed, they have not only strengths but also potential weaknesses which can as well be explained by the proposed here organizational economics approach. Weaknesses of partnership-based governance can be attributed to the fact that this governance, though clearly advantageous for the realization of common interests, contains latent forces that may lead to its replacement by hierarchy, with corresponding implications for crowding out and dissipation effects. In this respect, partnership-based governance can be regarded as paradoxical. Depending on the specific nature of these latent forces, two paradoxes of partnership-based governance can be identified.

One paradox relates to the role played by government in the operation of partnerships. On the one hand, as members of a partnership, governmental actors have the same powers as other members. On the other hand, outside the partnership boundaries, governmental actors clearly have more power than nongovernmental ones. The major challenge for the government is to ensure that its superior power as it exists outside the partnership does not spill over inside it, which would be equivalent to replacing partnership-based governance with hierarchical one. This challenge is definitely not an impossible one, but it requires adequate efforts at the preservation of 'good governance' within partnerships. These efforts give rise to transaction costs that need to be incurred in order to maintain partnerships in operation.

The second paradox relates to the fact that collective action entails costs that are not characteristic for individual action. These extra costs include e.g. those of search and identification of partners, communication and negotiation with partners, monitoring and enforcement of partnership agreements. These costs may provide motivation for some partnership members to try to replace collective with individual one. This may take the form of assuming the responsibility for some activities without seeking cooperation of other partners, or on the contrary, avoiding this responsibility in the hope that it will be taken by others. These tendencies will be again equivalent to replacing partnership-based governance, presupposing equal distribution of rights and responsibilities, with hierarchical one, where this distribution is no longer equal.

These two paradoxes of partnership-based governance are arguably well reflected in what has been termed ‘two fundamental characteristics’ of rural partnerships that significantly influence their impact on rural development—their property of ‘bringing together’ and their quasi-independence from the state and big bureaucracies that have traditionally dominated development programs (Moseley 2003, xxii). The extent to which rural partnerships exhibit these characteristics determines the extent to which these partnerships are really able to economize on transaction costs in comparison with market and hierarchical governance mechanisms. At the same time, these characteristics are subject to learning effects, as accumulation of respective knowledge may reduce the efforts that need to be taken to deal with the governance paradoxes.

On the whole, it is reasonable to differentiate between two types of transaction costs: those that are economized by partnerships and those that are generated by them. The overall efficiency of partnerships depends therefore not on how much transaction costs they economize, but rather on the balance between costs that they economize and generate. The costs that are economized are determined, as established in the previous section, by the extent of commonality of interests of individual partners; those generated depend on the presence of relevant knowledge and skills of partners as well as the nature of interpersonal relations between them (i.e., various aspects of social capital).

The discussion of paradoxes of partnership-based governance would be incomplete without mentioning the role of financial incentives in the creation of rural partnerships. Moseley (2003, xviii) reports that most of partnerships surveyed in his research had come into existence to take advantage of funding opportunities. This also presents a possible paradox that does not necessarily follow from the offered here theoretical framework: on the one hand, local rural actors take efforts to create partnerships, but on the other, what they are really interested in is not a genuine cooperation but rather acquisition of funds. Indeed, it may be even expected that these financial incentives may work toward crowding out of genuine cooperative initiatives. However, a careful application of the offered here argumentation suggests that it is by no means a necessary consequence of the existence of such financial incentives—because partners receive their financial rewards not at the expense of each other. In fact, these rewards truly lie in the common interest of partners and therefore definitely provide incentives for intensification of cooperation. The challenge is, of course, to ensure that the financial incentives are not the only ones, but the mere existence of such incentives by itself does not provoke crowding out effect.

Ⅴ. Concluding Remarks

The proposed here organizational economics approach to rural governance, in accordance with the general methodological tradition of organizational economics, posits that there exist a variety of governance mechanisms applicable to the organization of rural development activities. These mechanisms differ in their transaction cost-economizing properties. It has been argued that the major criterion of rural development activities, which determines the relative efficiency of alternative governance mechanisms in economizing transaction costs, is represented by the extent of commonality of interests of individual local actors in the undertaking of those activities. If this extent is sufficiently high, then rural partnership represents the most efficient mechanism, which minimizes transaction costs in the form of preventing crowding out and dissipation effects (in spite of the above discussed paradoxes of partnership-based governance).

Although the criterion of commonality of transaction participants' interests has been suggested by the rural development context, it appears to have wider implications for the organizational economics theory. Indeed, it has been shown that the commonality of interests is progressively increasing from markets through hierarchies to various forms of partnership-based governance. In this framework, transaction costs result from the inconsistence between the commonality of interests which is actually existing and that which is presupposed by the governance mechanisms actually employed. This is clearly different from the standpoint of the standard transaction cost theory which argues that the actually existing transaction costs are determined by the match between governance mechanisms and transaction attributes, such as asset specificity, frequency, and uncertainty.

The commonality of transaction participants' interests is by all means a dynamic phenomenon, in the sense that it is subject to change overtime. For example, the much discussed shift 'from government to governance' (Marsden and Murdoch 1998, 1), or, more precisely, to partnership-based governance, arguably represents a reaction to the emergence of common interests of local rural actors in the sustainable development of their territories. In turn, the emergence of these interests can be observed from the dynamic of political and scholarly discourse (as benchmarks, consider e.g. the Cork and Salzburg conferences). In line with this, it might be hypothesized that the transaction costs related to the development of rural areas are minimized by hierarchical governance in conditions of productivist agriculture (see e.g. Ilbery and Bowler 1998), in which there is not much room for voluntary initiatives that might be crowded out. However, as agriculture enters the post-productivist era, opportunities for crowding out significantly expand, which gives rise to crowding out and dissipation effects and hence increases transaction costs of hierarchical governance. Further research is needed to test the empirical validity of this argumentation.

A major challenge in the empirical verification of the offered here theoretical framework lies in the substantiation of relevant measurement methodologies for such variables as the commonality of local actors' interests, extent of reliance on partnership-based, hierarchical, and market governance, and the occurrence of crowding out and dissipation effects. Though these methodologies are likely to be case-specific, the identification of the empirical relationships between these variables will undoubtedly deepen our understanding of the way in which rural partnerships are actually operating.

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