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Beyond Economic Instruments - Social Capital, Governance and Rural Institutional Innovation

Dr. Catherine Murray
Auckland Regional Council
Email: catherine.murray@arc.govt.nz

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Beyond Economic Instruments - Social Capital, Governance and Rural Institutional Innovation

Dr. Catherine Murray

Auckland Regional Council

catherine.murray@arc.govt.nz

Economic instruments, or market based instruments try to bring market advantages to social dilemma situations, where private actions do not lead to socially optimal outcomes. Economic instruments try to redress such market failure. They try to create incentives for firms and individuals to act in the public interest. Such situations can be regarded as ‘social dilemma’. An alternative mechanism to solve social dilemma is to use cooperation amongst individuals, by facilitating and utilising social capital. The use of social capital is remains largely underexplored as a policy option, although this trend is changing, most notably in European rural development. Using evidence from research conducted on agricultural and rural institutions in central and eastern Europe, where extreme institutional change was caused by political shocks to the system, it is argued that policy is best directed at stimulating institutional innovation, through social capital formation. There are lessons applicable to problems evident in rural New Zealand.

Keywords: social capital, institutions, governance, central and eastern Europe.

Introduction

The transition from a planned to a market based economy particularly hit the rural areas of central and eastern Europe (CEE). The need to intervene in the rural economy and buffer the effects of radical institutional change was recognised by the European Union for its new member states (EC, 2005). Much of rural development requires actors in the countryside to cooperate in order to explore new business opportunities. However, it has been shown in the past that very often it was difficult for actors to come together for such initiatives (Theesfeld, 2004; Paldam/Svendsen, 2000), given low levels of trust between individuals, a mistrust of the state – a legacy from former communist times, and presumed low levels of social capital in these countries. This theoretical frame of this research is in the area of institutional economics, constructed as part of a project on Integrated Development of Agricultural and Rural Institutions (IDARI)[1]. This paper focuses on empirical evidence collected in that project: how groups of individuals decide to act and interact, in a situation where cooperation is desirable. Rural areas often suffer from diseconomies of scale, as distance and transaction costs can prevent the agglomeration effects often evident in urban areas. To overcome this problem, and to remain competitive, social capital (the use of networks and personal contacts) becomes important. Social capital is understood as the benefits of belonging to a network (Bourdieu,1986) or associated with the norms and networks of civil society that enable groups of individuals to cooperate for mutual benefit and allow social institutions to perform more productively (Putnam, 1995). Trust is a central component of social capital, as it determines the strength of these social ties. Fukuyama (1995) suggests that trusting societies have a common set of ethical principles and internalised norms, conducive to efficient dealings in the economic market. A successful example of social capital in operation for market advantage in New Zealand is evident in the dairy sector. The dairy farming community has developed a set of internalised norms, based on cooperation to retain (international) market competitiveness. This has been achieved in a deregulated climate after the 1984 reforms. Market forces have resulted in this governance structure, with minimal state intervention in the agricultural market.

This paper explores the role of government, market forces and communities in the formation of social capital. Encouraging the formation and use of social capital is an under-utilised policy option for rural New Zealand. The beneficial aspects of social capital were expressed by Serageldin and Grootaert (2000). The first is that *information is shared* and problems due to lacking or insufficient communication are alleviated. The second is that *activities are coordinated* because there are processes of interaction and adjustment going on between actors. The third is that *collective decision making* is possible because people trust each other. Thus - and the most compelling advantage of utilising social capital in rural areas - public goods can be provided and market externalities managed.

Rural areas within the former communist countries of eastern Europe provide an interesting laboratory to explore very dynamic institutional and social processes. In

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[1] IDARI (Integrated Development of Agricultural and Rural Institutions) was a European Commission funded research project under the 5th Framework Programming Quality of Life (QLRT-2001- 02718 FP5)

CEE the processes of institutional change have resulted from external shocks, imposed by political regimes and sudden regime changes over the last sixty years. The socialist regimes and centrally planned economies changed the social fabric of CEE, and resulted in particular types of behaviour between individuals. Most notably, was the effect on interpersonal trust, which resulted in complex trust patterns (both high and low levels) between individuals and groups of individuals. Within both economic and sociological theory, a person's institutional endowment is acknowledged, and part of that endowment originates in social ties or communities of association. This has been termed social capital, and relates to the extent that individuals benefit from their personal networks and communities of association (Bourdieu, 1986).

Institutional Change in Central and Eastern Europe

After world war two, the central and eastern European states had communist regimes imposed on them. Centrally planned economies changed the social fabric of the countries, most notably for the time in the collectivisation of agriculture, changing property rights in land ownership. The communist countries experienced a paradoxical system, which destroyed trust between people and government, while attempting to establish a community based on mutual trust (Lovell, 2001). Official hypocrisy, corruption, secret police surveillance and the suppression of meaningful citizen participation jeopardised trust, and thus it would seem, leave a legacy, hindering cooperation between people. However, particular patterns of behaviour emerged between individuals, ranging from strong mistrust of the state, to increased trust within close knit networks, families and kinship. The fall of the Berlin wall in 1989 marked the demise of strong communist control in CEE, with most countries gaining independence by 1991. The 'transition' period then began, with an overhaul of economic institutions in the switch to market economies. A process of reinstating private property and markets began, with steep social 'learning' in the use of economic instruments. Most importantly for rural areas at this time was the repatriation of property rights, and each country adopted different methods for untangling the web of complexity around their allocation. This coincided with the liberalisation of financial and democratic institutions, requiring trust in the state to uphold and protect the new property rights. In 2004 and 2007, further institutional change took place, with accession of the central and eastern European countries to the European Union[2]. This was further institutional change, and in preparation the countries had to align their economies and financial institutions to the monetary targets set by the European Union (EU) and adapt policies to ensure effective integration into the European economy and alignment with policy. Of particular relevance is the rural development regulation of the EU, which explicitly recognises cooperation amongst rural communities as a premise for securing funding. Rural development policy advocates the use and creation of social capital in its implementation, in the challenge to secure growth and sustainable development in rural areas. Evidence of cooperation at a local level is a precursor to securing

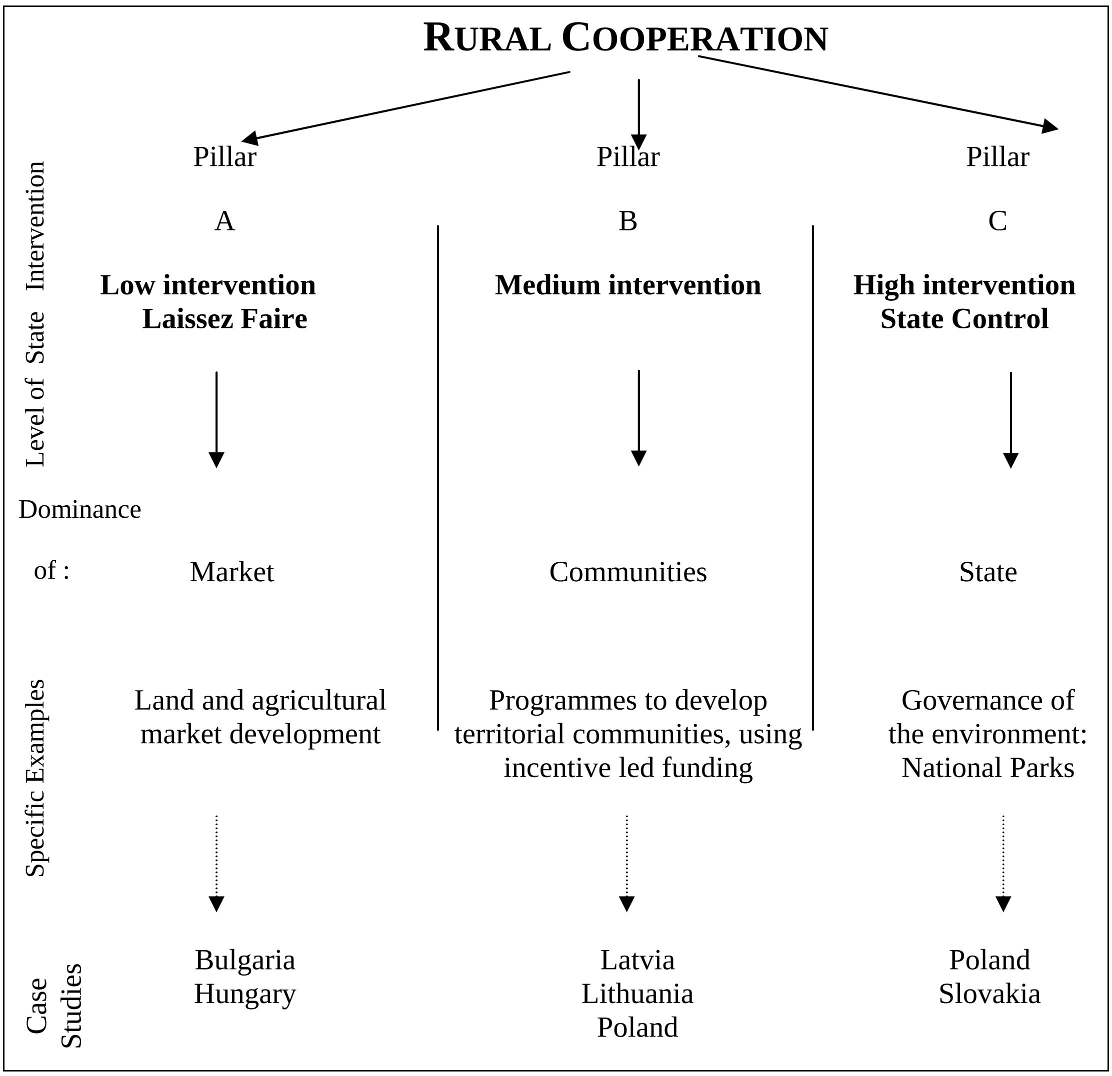
[2] Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia joined the EU in 2004. Malta and Cyprus also joined the EU at this date, but are Mediterranean state. Romania and Bulgaria acceding at the latter date

financial support from certain rural development funds. This is a strong policy incentive for collective action in rural CEE.

Theoretical frame and methodology

The research focused on how changes in social capital formation led to institutional innovations in a rural context. The theoretical framework utilised was based new institutional economic formulations of governance (Murray, 2008), drawing from, amongst others, Ostrom's (2005 and 2000) institutional analytical framework and studies on behaviour within collective action. It also drew from the social capital literature, which is still characterised by a variety of approaches and definitions. Social dilemma refers to situations in which individuals make independent choices in an interdependent situation. Each individual has a choice of contributing to a joint benefit, or a cooperators' dividend (Ostrom, 2000).

Figure 1. Framework for analysing cooperation



These notions of cooperation were explored in three different institutional settings, using a system of classification that organised the studies into three pillars, each representing varying levels of state governance on private property. This is particularly important for research in CEE due to the changing role and importance of private property in the years of tansition. These settings are defined by the dominance of markets, communities and state (Figure 1). It is recognised that each category is not mutually exclusive, and indeed it is important to remember that markets are groups of individuals (a network) rather than discrete entities in themselves (White, 2000; Hurrelmann, 2004). Likewise communities influence markets and the state, so this delineation is somewhat fluid. Within the market setting a low level of state intervention is assumed, whereby the government upholds property rights through arbitration, as the need arises. In the community setting, it is assumed there is a certain level of government intervention in property rights insofar as the government offers incentive schemes for communities to act collectively. Within the state setting, there is a high level of government intervention in terms of ownership and rules over resource use. This is in the form of environmental regulations within a national park.

Empirical data was collected by researchers in six CEE countries. A popular approach in case study research was chosen, which is the use of a multiple-case design with replicated cases (Yin, 1994). This allows comparison between cases in different settings but with the same underlying situation. The connecting element between these cases is the fact that they were all rural development initiatives requiring cooperation between stakeholders. Guidelines for the design of the case studies were agreed upon by all researchers. All interviews were conducted in the vernacular. Seven case studies were completed for this component of the research : two in Poland, and one in each of Hungary, Bulgaria, Slovakia, Latvia and Lithuania. Although the institutional environment differs in each country, and indeed within regions of the same country, six cross cutting themes were identified for minimum comparison of the cases. These were:

a. The role of trust/mistrust and opportunism
b. The role of communication and learning on cooperation
c. The role of transaction costs and changes in governance on cooperation
d. The role of the State (both national and European Union) and formal institutions on cooperation
e. The role of communities, social networks and informal institutions on cooperation
f. The role of the market and competition in fostering/hindering cooperation

The first two themes relate to the formation of social capital, and how information is transmitted within a network of individuals. The third theme looks at the extent to which cooperation is a rational choice, resulting in a reduction in transaction costs for the actors involved. The last three themes explore the driving forces of state, market and local communities on cooperation, exploring incentives around state intervention or lack of (*laissez faire* market approach) and dynamics of community driven initiatives development in rural areas. The following section summarises the cases.

Evidence from Central and Eastern Europe

Low state intervention

Within the market pillar, data was collected from two locations in Hungary and Bulgaria. The town of Hajduboszomeny was selected for analysis in Hungary (Forgacs, 2005). In former times, agricultural production was organised collectively in the form of cooperatives. Despite the fall of the socialist system, not all institutions collapsed, and there are examples of continued cooperation within such agricultural cooperatives. One such cooperative was studied, and contrasted to a newly established (late 1990s) agricultural cooperative in the same town of Hajuduboszomeny. The conclusion was that there is potential for successful cooperation given the tendency of personal trust to be present. However there was little trust in and communication with authorities, and little interaction with other actor groups. Thus the issue of leadership was crucial. This finding was interesting as most of the literature on social capital does not acknowledge the need for a 'mediating agency' but expects collective action to happen 'automatically' where enough social capital is present (Hurrelmann et al, 2006). The premise that high social capital leads directly to greater political participation is not analytically or conceptually clear. In Bulgaria, the selection of the case followed a different logic. It was not due to evident cooperation, but where cooperation was required and essential for effective market functioning that determined the selection (Aleksiev & Penov, 2005). The issue of land fragmentation is specific to Bulgaria, due to the inheritance laws relating to property. On the death of a property owner, the land is split between all offspring. Land was repatriated in the early 1990s, on a retrospective basis, from the last deeds prior to collectivisation of the land in the 1940s. These descendents had oftentimes left the area, had no identifiable connection with the village/land. This led to a situation of absentee landowners and much uncertainty about ownership. Fragmented plots are a hindrance to farming systems, and debilitate the markets for certain agricultural products, and the land market itself. The plots are not necessarily physically discernible, given that fields were consolidated in communist times with boundaries removed. The village of Dubene in the Plovdiv region was selected, and despite its small size, had 1350 landowners. Limited cooperation within the village was identified to overcome the land fragmentation problem, in the form of agricultural cooperatives, farmer partnerships and family members working together on (extended) family farms. In the attempt to establish the land property market, with repatriation of land and systems to reintroduce the basic market premise of property rights, the secondary effects were not considered. This is understandable, given the complexity of issues and obfuscation around property rights. However planning at the policy level could mitigate the adverse effects on the farming systems in place.

Medium state intervention

Within the community pillar, three case studies were undertaken. The first in the Carpathian region of Poland focused on a project attempting to create a place based brand for marketing purposes. The Carpathian case looked at cooperation within the Bieszczady's regional identity for food and non-food produce from the area. Limited funding was given to coordinate the project. Bieszczady forms a microregion (strong self identity), a complexity in the study emerged due to the overlap of administrative districts (voivodships) and communes, accompanied by geographical and social isolation of the producers. Despite this, the project was considered a success, as it had strong leadership. This can be considered ‘coordinated cooperation’ with central importance of the project organisers and leaders, despite little cooperation amongst the producers themselves.

The second case study looked at community led cooperation in rural Lithuania (Zemekis, 2005).The ‘PHARE 2000 – Economic and Social Cohesion’ project, funded by the European Union provided an incentive for communities to work together for a common purpose. The project to create a tourism infrastructure along 140 km of the Jura river waterway required the statutory agencies (in Taurage county) involved in the project to cooperate with one another, although separated geographically. The initiative was successful, insofar as it resulted in the formation of a network of civil servants, who worked together. The project had limited scope in including broader communities, although certain business people were included in the project (tourism operators for kayaking on the river). It is important to recognise the importance of re-education of CEE officials and bureaucrats in policy implementation during institutional transformation. Learning occurs at many levels and coordination does not necessarily spontaneously emerge. The case also highlighted the problem of identifying communities or groups, which remains unresolved in the literature (Khumar, 2005; Agraval and Gibson, 1999)

The third case study in this community pillar differed from the other two, as it was a grassroots, community led initiative, rather than a response to available funding. It was similar in the respect that it was a marketing exercise in the tourism industry. The Rauna Tourism Association in the Cesis district of Latvia aimed to share information and promote the town as a tourism destination (Zobena, Summane and Kalnina, 2005). The community were attempting to market their rural resource, and realised the mutual benefits could be gained from working together. It also differed in that the activity took place in a more limited geographical area than the other two cases. There were fewer actors involved in the initiative. The Rauna Tourism Association was founded on the initiative of one individual, a farmer who himself runs a multifunctional farm business including rural tourism. In the first year of its existence, the association received funding from the municipal government, which paid for the association’s office and the job of a coordinator. This may have contributed to the fact that the actors involved in the Rauna Tourism Association expressed a rather high degree of trust in the local municipal government, relative to the national government and the European Union. However, the financial possibilities of the municipality were limited and while staying generally supportive of the initiative, the local government did not continue the funding after the first year. The main obstacle to success was identified as a lack of long term vision for the organisation, and interest in the organisation was waning, with declining membership. Motivation was declining, and the private benefits to individuals were not perceived great enough to continue cooperation. Zobena (2005) concluded that there was a lack of direction or leadership after the initial formation of the group.

High state intervention

The third pillar is that with high state intervention. Two cases of a national park designation were investigated. These are interesting, as such designations reflect the command and control style of governance of former times, in that landowners and resource users within the park bounds are limited in their actions. Rights over resource use are defined by the state, for the preservation of nature. The Polish Drawinski National Park is situated in the north-west, at the border of three administrative regions (Matczak, 2005). The park is relatively new, established in 1990, fulfilling the requirements of IUCN II category. It is predominantly woodland, with some waterway and abandoned fields and meadows. It is valued for its biodiversity and recreational value. Although economic opportunities within the area are limited, there is contestation over the use of resources, especially commercial and farming interests on the outskirts of the park. The second example of state intervention is the Slovenski-Raj national park, in the north-east of Slovakia (Kluvankova-Oravska, 2005). It has a longer history, as it was protected as a natural area in former times (from 1964) and gained national park status in 1988. It is an eroded karstic benchland, having picturesque canyons, waterfalls and rivers. As with the Drawienski national park, the administration of the park is divided between municipalities – adding complexity to its governance. There are problems of finding a balance between nature conservation, economic interests (especially tourism and farming) and informal user rights (logging) in the park, leading to mistrust and stasis. Cooperation is required, by all stakeholders, for sustainable management of the parks. These case studies point out that the former regimes, operating on the basis of massive state intervention and state monopolies, resulted in a dramatic decline of trust in formal authorities and institutions. Furthermore the historical situation has meant that there is little resilience in the governance structures of the new representatives, and a lack of competencies in governance of the national parks has been identified. Conflicting legal provisions were also identified in the governance of the parks, making effective management difficult, particularly in the Slovak case.

Some of the key findings from these case studies were that the legacy from former times persisted, leading to a mixed role of trust in the social capital matrix. There were examples of cooperative behaviour between actors in rural CEE. Cooperation is thus seen as a governance structure – a rational strategy in some instances. The integration of the CEE countries into the European Union provided an opportunity to analyse the effects of incentive led cooperation. The rural development regulation required and encouraged network formation. It became clear that the role of a leader in a group was crucial. The presence of social capital did not necessarily result in its optimal use for the members of the network, and bridging social capital is important, especially between individuals and the authorities.

Discussion

When attempting to assess whether the ‘time has come’ for economic instruments in the New Zealand context, it is of use to examine alternative options. Although no parallel can be drawn between rural New Zealand and the former communist countries in terms of the historical influence on social norms, both countries have experienced economic ‘shocks’ to the system. Neoliberal reform in the 1980s exposed the New Zealand farming community to the vagaries and opportunities of unbuffered international markets. From the 1990s onwards, the central and eastern European countries were exposed to market forces, after fifty years of a command and control approach to the economy. Low levels of social capital were identified in central and eastern European countries, alongside persistent mistrust of the state. Despite this, cooperation is evident as is collective action for solving social dilemma.

Rural New Zealand does not have such a handicap in its social fabric. There is active social capital processes evident in activities undertaken around educational centres (schools and pre-schools), in farm discussion groups, in the informal institutions (for example A&P shows, livestock yards and social clubs to name but a few).

The issue is how strong interpersonal trust among motivated, well educated and well connected leaders of rural communities in New Zealand can be harnessed in a more productive manner. Perhaps an obstacle which needs to be overcome is the gap between local people and authorities. A second obstacle to successful cooperation is if the (perceived) benefits for cooperation are not clear to individuals. This is perhaps the role of local leaders, to provide credible information making clear the expectations of participating in groups and networks.

In Europe there is a trend toward harnessing the existing social capital in rural areas, encouraging cooperation and collective action amongst actors. After the initial transition phase in central and eastern European countries, the European Union provided guidance and policy for agricultural and rural development. The current trend in European policy has been described by Osti (2000) as an attempt to substitute hierarchical intervention with a system characterised by network and market relationships. The benefits of shared information (reduction in transaction costs), coordinated activities and collective decision making are the rewards for mobilising and utilising social capital.

There is an underutilised resource of social capital in New Zealand. The presence of a resource does not necessarily mean it is used effectively. It can remain untapped. The case studies in this paper showed that despite a perceived handicap in the existence of the resource of social capital itself, policy can provide incentives for its mobilisation. This can provide an alternative to the use of economic instruments, given the transaction costs involved in their implementation.

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