

# Property rights reform on agricultural land in Central and Eastern Europe

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## Abstract

This paper discusses processes of property rights reform of agricultural land and non-land assets in Central and Eastern European countries. It presents some selected approaches developed and applied during the last decade in order to explain and to understand this unique process of institutional change. The research framework and theoretical concepts are predominantly based on New Institutional Economics and Public Choice approaches. Among others the discussion shows the crucial role of the ownership-status of land after collectivisation or nationalisation, the ethnicity of asset ownership prior to the socialist era, the equality of asset distribution before collectivisation or nationalisation, and the persistence of social values, human capital and informal institutions. In addition, the applicability of main theories of institutional change is discussed, i.e. the Efficiency Theory, the Public Choice Theory and the Distributional Theory of Institutional Change. The results illustrate that the distributional theory, which considers the change of institutions and the emergence of new ones as a by-product of strategic conflict over substantive social outcomes, proves superior to the other approaches. It also becomes evident that property rights reform cannot only be conceived of as establishing effective private property rights, because all types of property rights and property rights on different attributes of land and related natural resources like water and biodiversity are in a process of change, and the directions of change may be quite heterogeneous. Finally, the role of shared mental models in transition societies and the importance of social capital for successful institutional change are emphasised.

**Keywords:** property rights reform, privatisation in agriculture, Central and East European transition, institutional change, Public Choice, policy formation, analytic narratives

## 1. Introduction

In this paper, processes of privatisation and restructuring of agricultural land in Central and Eastern Europe will be considered as phenomena of institutional change which can only be controlled to a limited extent. This is in contrast to the view that such institutional innovation was actually following pre-designed concepts which could be

precisely implemented by political and administrative actors. Accordingly, just focussing on conventional policy recommendations by saying “what governments should do” without having gained sufficient knowledge on the particular actors and institutions in the country in question may be more detrimental than helpful. The ability of internal and external political actors to govern and to control real changes in institutions, that means not only formal ones such as new laws which are often insufficiently implemented, is rather low in transition countries. In addition, some political elites in several transition countries have developed a culture of extreme “rent seeking”, sometimes also characterised by the terms “the grabbing hand” (SHLEIFER and VISHNY, 1998) or “the roving bandit” (OLSON, 1995, 2000). This means that the activities of such powerful actors are not automatically and primarily oriented towards policies and institutions that improve the well-being of their society (HANISCH, 2003: 97). Certainly, this does not equally apply to all transition countries and to all political actors in these countries.

This paper is organised as follows: first, we will draw an outline of analytical approaches that emerged at the beginning of the transition period to find the determinants of land privatisation and agricultural restructuring. In this phase, a distinction was made between historical factors and determinants originating from the property rights formation process itself. Then a more complex conceptual framework based on theories of institutional economics and political economy is presented, which was applied in a comprehensive research project. The results from this research phase are based on empirical studies on institutional change<sup>1</sup> conducted in selected transition countries. Finally, issues of lack of social capital in the transformation process as a field for further research is discussed.

## **2. First approaches towards an understanding of agricultural transformation**

Similar to transformation studies for other parts of the economy, those on agricultural transformation mostly were normative at the beginning of the transformation process. The underlying assumption was that privatisation of agricultural land and other

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<sup>1</sup> In this paper, the basic functions of institutions are defined in accordance with the understanding of institutions prevailing in institutional economics: “Institutions are the rules of a society or of organizations that facilitate co-ordination among people by helping them form expectations which each person can reasonably hold in dealing with others. They reflect the conventions that have evolved in different societies regarding the behavior of individuals and groups relative to their own behavior and the behavior of others. In the area of economic relations they have a crucial role in establishing expectations about the rights to use resources in economic activities and about the partitioning of the income streams resulting from economic activity – ‘institutions provide assurance respecting the actions of others, and give order and stability to expectations in the complex and uncertain world of economic relations’ (RUNGE, 1981: XV)”, (RUTTAN, 1984: 2f.).

agricultural assets and restructuring of farms should be determined by the aim of economising transaction costs within the farm firm (see SCHMITT, 1991). Consequently, two main questions were discussed:

- a) Which farm size - as a proper target of privatisation and restructuring – will prove superior? To what extent will digressive production costs be accompanied by likewise digressive transaction costs or, in contrary, be outweighed by progressively increasing transaction costs?
- b) Which organisational structure of the privatised and restructured farms will be the most competitive, if production co-operatives are compared with family farms, for example?

However, already at the beginning of the nineties, SWINNEN (1992, 1993, 1994) argued that it may be sufficient just to look at the farm unit as a transaction-cost saving entity if we are in a well developed, stable farm economy which is not affected by major changes due to structural adjustment or reform policies. In a period of fundamental transformation of the farm sector, however, the whole network of relationships between the actor and organisations in the agricultural sector has to be taken into account, including the (changing) rules they are based on. Thus, several additional factors had to be included into the analysis:

- the particularities of the starting situation regarding farm organisation and agricultural structures, e.g. size of the plots belonging to land owners and availability of capital,
- relationship to other institutions related to agriculture such as access to inputs, marketing co-operatives, extension services, credit institutions, information systems, etc.,
- the Political Economy of agriculture, especially with regard to different interests, special constraints and emerging conflicts due to privatisation and de-collectivisation policies,
- the evolutionary characteristics and potential path dependency which may come into being during the transformation process and may lead to different routes of change.

“Consequently, the policy advice for the restructuring of CEE agriculture should not ignore the existing structure and/or the institutional and policy environment and should not limit the relevant variables to the initial and final equilibrium situation. Rather, it should explicitly include the process of change in the analysis” (SWINNEN, 1994: 4). Thus, there are reasonable arguments which show that the isolated (and static) perspective of only the farm unit is an “approach in a vacuum” (SWINNEN, 1994: 12).

These initial insights into the complexity of the transformation process indicated the necessity of more systematic attempts.

### **3. Basic elements for a systematic explanation of institutional transformation**

One of the main institutional questions reform politicians had to deal with was whether and how private property rights in land should be re-introduced. There were two conflicting answers to this question:

- Ownership rights in land should be given back, i.e. land restitution in historical boundaries should be supported in order to do historical justice.
- Land restitution in historical boundaries should be avoided because it leads to inefficient agricultural structures. Instead, land should be sold or distributed by a voucher system.

The Central and Eastern European countries have made very different decisions with regard to these options (see SWINNEN, 1994, 1996, 1997; SWINNEN and MATHIJS, 1997; SWINNEN et al., 1997; HAGEDORN, 1997, 1998; LERMAN et al., 2004).

#### **3.1 The diversity of transformation procedures in transition countries**

Restitution of land to previous owners was a general rule of privatisation in Central and Eastern Europe. However, there are manifold exemptions as the following examples illustrate:

*Russia/Ukraine:* Restitution was not feasible because the previous borders were no longer available. Land was distributed to the rural population on a per capita basis. Privatisation remained incomplete with regard to the extent of effective rights actually transferred to individuals.

*Baltic States:* Restitution to former owners was accepted as a general rule, but only for ethnic Estonians, Latvians and Lithuanians; ethnic Russians were excluded from land distribution.

*Romania:* Restitution of land to former owners was combined with per-family distribution of some land. Land expropriated prior to 1947 was not restituted.

*Bulgaria:* Restitution of land to former owners in historical boundaries was initiated after 1990 by means of a bureaucratic procedure, but the process proceeded only slowly and was frequently modified by changing governments.

*Albania:* After an initial period of “wild privatisation” land was distributed on an equal per-capita basis. The political forces, which preferred this strategy, were stronger than those politicians who represented the interests of former owners (mainly the nobility).

*Hungary:* Priority was given to voucher privatisation, by which two thirds of the land owned by the collective farms were distributed. This strategy supported the survival of large farms.

*Slovenia:* To a large extent, the small family farms had not been collectivised or nationalised. Land was returned to former owners, but Italian citizens were excluded from land restitution.

*Czechoslovakia:* Land expropriated prior to February 25, 1948, was not given back to previous owners. Collectivised land was returned to the original owners. After the country was divided into the Czech and the Slovak Republics, some differences in the privatisation strategies came up. In the *Czech Republic*, land formerly owned by the Catholic Church was not restituted. In the *Slovak Republic*, the government changed the date of reference in a way that allowed for restitution to the Catholic Church.

*Poland:* The major part of agricultural land in Poland is operated by family farms, which were neither collectivised nor nationalised. Most of the nationalised land belonged to Germany before World War II. Poland avoided restituting it to Germans; state-owned land has been leased or sold.

*Germany:* No restitution of land and other property to former owners expropriated during the so-called land reform from 1945-1949 took place. This land has been pre-privatised by long-term lease contracts and is sold at approximately half the market prices by a land acquisition programme. In contrast, land expropriated or collectivised later than 1949 was restituted.

Non-land assets were usually not restituted. Instead, they were privatised by a voucher system or transformed into capital shares in the reformed co-operative farms.

### **3.2 Historical determinants existing at the starting point of transition**

At least some of these differences can be explained by historical factors that influence the process of privatisation and restructuring but cannot be considered as being endogenous to the process. During this process, conflicting goals played a role, mainly economic efficiency and income distribution. The goal of income distribution can be differentiated into two objectives that have not always been compatible in the process: equity as a social concern and doing historical justice as a legal demand. In countries like Bulgaria, exhibiting rather egalitarian land distribution prior to collectivisation,

these objectives were more or less compatible. In countries with unequal distribution of pre-reform land ownership, like in Albania, they were conflicting. Some of the conflicts involved in land restitution can be explained by the following determinants:

- the ownership-status after collectivisation or nationalisation,
- the ethnicity of asset ownership prior to the socialist era,
- the equality of asset distribution before collectivisation or nationalisation, and
- the persistence of social values, human capital and informal institutions.

(1) If we look at the impact of the legal asset ownership after collectivisation, we must distinguish between land and other assets. Both kinds of property are usually treated differently. The first reason is that land is still physically available. Its quality may have been changed, e.g., by investing in drainage or irrigation systems, and it may no longer lie adjacent to a road, due to land consolidation which was connected with the collectivisation process. But it can still be given back as a physical unit. This is not true with regard to other assets like cattle or machines. At the beginning these assets were collectively used, but after collectivisation they were still privately owned. However step by step, they were replaced by new assets, i.e. by new machines or by other animals. Therefore it is impossible to return the original assets to the former owners.

In the case of land, people often still held the *formal* ownership rights, although they were no longer allowed to decide on the use of the land, i.e. they did not have *effective* property rights. In this case, privatisation does not mean the transfer of legal ownership rights, rather than the transfer of effective property rights. It was impossible for the government to choose a different privatisation procedure in these cases than land restitution. Otherwise they would have taken away the legal ownership rights from the formal or legal owners. SWINNEN (1996) emphasises that it would have been extremely ironical if private ownership rights, after having survived forty years of collectivisation and state control, would be confiscated by governments that were democratically elected.

(2) The impact of ethnicity results from the fact, that the privatisation policy affects the distribution of assets between ethnic groups (which may live inside or outside the country). For example, most of the countries did not reconstitute land to foreigners and have even restricted land sales and land renting to foreigners. Poland does not sell the land of the state farms formerly owned by Germans to foreigners, and the same is true for land formerly owned by the Sudeten-Germans in the Czech Republic. In Slovenia, Italians owned some of the land that was nationalised after World War II, and they were also not reconstituted. In the Baltic states, Russians as a large ethnic minority were not integrated into the process of privatisation. By restricting restitution to former

owners, they were excluded, because former owners were all native Latvians and Lithuanians. In this way, the restitution policy secured land ownership only in the hands of native citizens.

(3) Distribution of land ownership before collectivisation is important as a determinant of the privatisation process, because it determines to what extent the objectives of “historical justice” and “social equity” are conflicting or compatible. If pre-collectivisation land ownership was egalitarian as it was, for example, in Bulgaria, restitution of land is promoting historical justice as well as social equity. However, if it was more unequal distribution, then historical justice and social equity became conflicting objectives. Albania is a good example for this (see CUNGU and SWINNEN, 1999). Here two different political parties which both belong to the anti-communist group represented these conflicting objectives. Both strongly supported privatisation and de-collectivisation, but one of them favoured land restitution to former owners and the other one wanted land to be distributed among farm workers. In Albania, land distribution was very unequal prior to collectivisation. In the best agricultural regions of the country, the land was owned only by a few families, while a large part of the population was working as hired labour in agriculture. Therefore, land distribution on an equal per-capita basis favoured a large number of voters, which seemed to be a more influential political factor than the interests of the former landlords.

(4) Social values and human capital represent important reasons for the persistence of informal institutions. Formal institutions can suddenly be changed in a process of revolution. However, informal institutions such as social customs and norms do not change so easily. Privatisation and land reform may effectively destroy and break up the previous formal arrangements, but this may be different with informal institutions and human capital. For example, in some post-socialist societies like in Russia, private ownership of land is not very popular because it is often considered immoral (SCHULZE et al., 1999). This could be one reason why the revival of very large private farms to be observed here (KOESTER, 2003) may provoke social conflicts in rural areas.

### **3.3 Determinants arising from the interaction between political decision makers and other actors involved in the process of property rights formation**

Whereas the above-mentioned factors appeared to be rather clear, less progress could be made in explaining political and administrative determinants. Some observations and hypotheses were discussed:

(1) If formal ownership rights are transferred to individuals, this does not automatically mean that these individuals also have received effective property rights. For

example, restitution does not always take place in original boundaries, but it is usually also allowed to give the previous owner a comparable piece of land, i.e. restitution in comparable boundaries. It may be difficult for the new owner, to get his plot of land out of the reformed collective farm because it usually was assigned by the management of the reformed farm. Provided that the claimant has access to the legal system, he can go to court if he does not get his land or disagrees with the assignment. “Restitution in comparable boundaries” has important impacts on the bargaining power between collective farm management and the person who wants to retrieve his or her land. In the presence of transaction costs, formal property rights that are restituted may not or only insufficiently become effective (see SWINNEN, 1996).

(2) Another reason why formal or legal ownership rights may be incomplete are implementation problems and obstruction occurring at the level of local administration and the level of collective farms. Usually, governments face principal-agent problems as far as their relationship to the implementing agencies is concerned. Particularly, governments in transition countries have to deal with considerable difficulties in monitoring and controlling the implementation of the reforms (see Section 4).

(3) The tasks of the staff working in the ministries and other administrative units in Central and East European countries have changed fundamentally. Formerly, they were involved in the process of central planning and needed predominantly technical knowledge. Now they had to implement agricultural policies for structural adjustment, privatisation, environmental protection, social security, etc., and this often requires new knowledge and procedures.

(4) After 1990, there were opportunities for reform politicians in transition countries, i.e. they could decide for reform-oriented policies without facing serious opposition. However, soon the costs and social hardships of the reforms became obvious, and the groups who were negatively affected protested against the new policies. This also contributed to the recovery of the so-called “old forces” in some of the countries. For example, in Bulgaria the liquidation committees established to transform collective farms were replaced by new administrative units. Which political coalition will dominate in the long run, crucially depends on the political economy of the transformation process. One possibility to achieve a reliable basis of political support may be to create “a large group of property owners in society” that “will result in a long-term constituency for ‘reform-minded’ politicians and parties” (SWINNEN, 1994: 10). These landowners will then support those politicians and parties that will help them to obtain the highest returns to their property. However, there is also the opposite way to build a long-term constituency that can make anti-reform politicians and parties more competitive than reform-minded. By stabilising old structures, like large-scale

collective farms, a group of voters can be addressed whose social and economic well-being depends on agricultural policies.

#### **4. A comprehensive conceptual framework based on theories of institutional economics and political economy**

This discussion on the “*endogenous factors of privatisation and restructuring*” raised more questions than answers. As a consequence, additional research was initiated, for example, the KATO project<sup>2</sup> (HANISCH et al., 2001), which focused on the transition process in three Central and Eastern European countries. In Poland, the Czech Republic and Bulgaria, processes of liberalisation and market development, privatisation and property rights changes, as well as restructuring and path dependencies were analysed. The results can be attributed to three analytical levels: (1) the empirical design for analysing rapidly changing and evolving institutions in transition economies, (2) the suitability of different theoretical approaches for understanding transition, and (3) policy recommendations targeting better governance and an improved institutional framework.

##### **4.1 Research framework for the analysis of property rights reform**

The KATO project explored main areas of agricultural transition to create an understanding of the process of agricultural transition. Three types of studies were selected<sup>3</sup> which can be classified according to WILLIAMSON’S concept of “four levels of social analysis” (LSA<sup>4</sup>).

1. *Property rights formation (LSA 2)*: For analysing the process of property rights formation in agricultural land and non-land assets, selected hypotheses from Public Choice and Transaction Cost Theory and from the Theories of Social Conflict and Collective Action were combined to explore the explanatory power of the different hypotheses (HANISCH, 2003; MILCZAREK, 2002; SCHLÜTER, 2001).

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<sup>2</sup> KATO = Comparative Analysis of the Transition Process of the Agricultural Sector in Selected Central and Eastern European Countries, Humboldt University of Berlin, 1997-2001.

<sup>3</sup> This section only provides a brief outline of the overall framework of the KATO project and the concept of studies on property rights reform conducted within this framework as a sub-area of the project. For a more detailed description see HANISCH et al. (2001) and HANISCH (2003).

<sup>4</sup> WILLIAMSON (2000: 597) distinguishes four levels of social analyses: “(1) Social embeddedness: informal institutions, customs, tradition, norms, religion; (2) Institutional environment: formal rules – esp. property rights (policy, judiciary, bureaucracy); (3) Governance: playing the game – esp. contract (aligning governance structures with transactions); (4) Resource allocation and employment (prices and quantities, incentive alignment)”.

2. *Governance structures (LSA 3)*: Based on transaction cost theory, restructuring/downsizing of post-socialist agricultural firms (BREM, 2001) and contracting forms in the hog supply chain (BOGER, 2001) were studied.
3. *Efficiency of resource allocation (LSA 4)*: The influence of market competition on the technical efficiency of different types of organization (CURTISS, 2002), the technical efficiency of different organizational forms of farms (KANEVA, 2000), the effectiveness of investment support programmes (CZERWINSKA-KAYSER, 2000) and the impact of different reform policies on economic growth (PAVEL, 2001) were analysed.

Between these three groups, the studies differed in terms of their research questions, empirical methodology and theoretical concepts. However, the group of studies dealing with the formation of property rights in land and agricultural assets in Bulgaria, Poland and the Czech Republic followed a homogeneous approach. They focussed on the question of what factors determine the formulation of property rights (LSA 2), and how the resulting institutions become socially accepted rights of action in the process of implementation and co-ordination (LSA 3 and 4) (HANISCH, 2003; MILCZAREK, 2002; SCHLÜTER, 2001). Public Choice and Positive Political Theory approaches were used to analyse the political process that led to the choice between alternative forms of asset privatisation and land reform measures. Actor constellations at different levels of social analysis were identified for investigating the decision-making processes responsible for the formation of economic rights and rules.

The analyses of land privatisation and property rights reforms were based on a qualitative case-study approach that focused the empirical analysis of decision-making processes and actor constellations. The actor- and process-oriented case studies included the links and interactions between different levels of social analysis. This approach, which used in-depth interviews with numerous relevant actors, proved particularly useful for obtaining detailed information on the process of law-making. As these reform laws affected the situation of many actors involved and defined their economic rights of action at the level of private ordering, the empirical approach paid special attention to the distributional characteristics of these impacts.

As the research subject is both complex and dynamic, HANISCH (2003) designed a research framework (see figure 1) which was “taking an actor-based, rational choice perspective” (SCHARPF, 1997: 36-50). Each actor is considered as a decision maker and, each decision is analysed in the context of potential alternatives and of other actors’ decisions” (HANISCH, 2003: 120-123). This actors-oriented framework reflects the process of property rights formation during the transition process (as shown in figure 1). It employs a rational choice model for analysing the *Choices and Actors in*

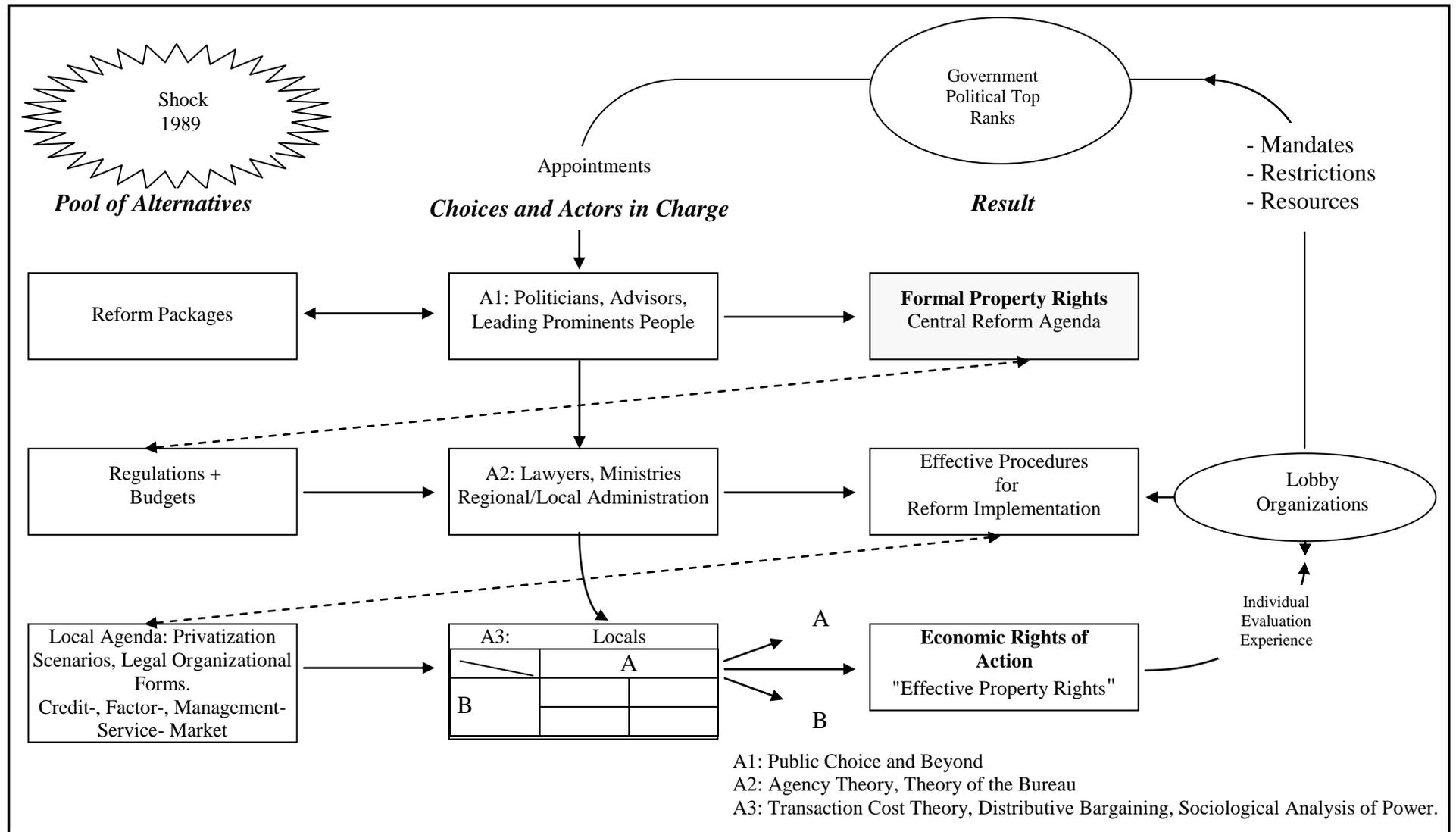
*Charge* as regards both their individual and collective decisions. “To the left of each actor there is the *Pool of Alternatives* to consider while analysing decisions. *Results* from choices at the political level (A1) turn into restrictions (slashed arrows) on the choice of alternatives on the subsequent levels of decision making, as appears on the level of reform implementation (A2) and the level of private ordering (A3). Here governance structures arise and the perceived income distribution feeds back to the constellation of political actors (policy cycle). The slashed arrows point in two directions. This means that decisions on a higher level are constrained by the respective political and implementation costs which consequently arise and which allocate a price to each political and administrative decision” (HANISCH et al., 2001).

*Level A1:* For explaining political decisions on land reform and privatisation of agricultural assets, the political influence of the rural electorate and the specific features of the discussed choice alternatives (reform packages) are taken into account. The hypotheses about the objectives of actors are derived from Public Choice Theory and refer to the motivation of defending political power, or following certain party ideologies (SWINNEN, 1997). The efficiency of reform policies is evaluated in view of ‘The Pool of Alternatives’ and the cost of consensus building and implementation.

*Level A2:* These bureaucratic decisions can be explained by the cost of implementation and the principal-agent problems between government and administration. Formal rights and reform policies have to be interpreted by bureaucracies. The options open to actors are constrained by budgets available or written laws, and by the tools that control bureaucrats. Transaction cost and principal-agent hypotheses concentrate on the objectives and elbow room of important actors involved, the incentives to carry out or boycott implementation, or those who extract money through corruption.

*Level A3:* After property rights reform, two general questions arose for the local actors: first, what should they do with their formal land rights? Second, what should they do with their vouchers on physical assets? The new formal property rights had to be exchanged to become rights of action (BARZEL, 1989: 2). Concrete decisions, for example setting up a single contract for renting land or the establishment of whole agricultural firms, have to be conceived of as the real process of forming new property rights. In this process income is generated, distributed and protected and the value of each actors’ share of income from exchange and coordination reflects the nature of the property rights involved.

**Figure 1: A comprehensive research concept**



Source: HANISCH (2003)

## 4.2 A methodology for the analyses of political interaction

Such a framework enables the researcher to investigate the property rights process at different decision-making levels similar to those suggested by WILLIAMSON (2000: 597). The components of this system can be considered as “intellectual bins” (MILES and HUBERMAN, 1994: 13), and the relations between them can be described by hypotheses taken from various fields of Rational Choice Theory, as pointed out in detail by HANISCH (2003: 124-125). “At the top of the graph are politicians influenced by lobby groups ... and constrained by economic data and elections as well as by mental models and their ideological orientation. At the middle are bureaucrats in charge of reform implementation, and at the lower level are locals determining how to organize and perform transactions. Each group of actors is placed before an informal background between the pool of available alternatives at the time of decision making and other actors’ decisions” (DIXIT, 1996: 35).

In particular, the relationship between higher and lower levels is relevant during the transformation process. If a political system is stable, political actors are sufficiently constrained, for example by pressure from competing interest groups or demands from international organisations. Actors at a superior level are able to influence the alternatives of actors at the subsequent level (EGGERTSON, 1990: 7-9), and vice versa. In other words, the scope for deviating from the preferences of citizens and voters is rather limited. In contrast, “the less constrained the government is by competing pressure groups like trade unions, students, the army, foreign organizations (IMF) or powerful trade partners, the more probable bandit-like behaviour is (MCGUIRE and OLSON, 1996: 72-96). ... In times of political instability, the options open to bureaucrats are less constrained and the perspective of all actors becomes short term with regard to economic decisions (BROADMAN and RECANATINI, 2000; KOFORD, 2000: 307-338). Each actor’s incentive to grab as much as possible, as quickly as possible is augmented, and state control of the outcome of policy implementation is reduced. Coupled with delayed development of markets and little competition among actors on the level of market transactions, state influence on the choices of low level actors and the effectiveness of formal property rights may be comparatively small. In this situation, actors cannot credibly rely on the state as a third power for conflict settlement. They have to bear the costs of dispute settlement action on their own (WILLIAMSON, 2000: 599). Economic rights of action will deviate from formal property rights (BARZEL, 1989: 2). In times where markets cannot fulfil the task of providing cheap business alternatives, market entrance and exit, the resources to protect one’s property, to credibly threaten others or to wait for better deals become valuable to influence the property rights process” (KNIGHT, 1992: 133-136) (HANISCH, 2003).

Admittedly, such a framework is too complex to be filled with empirical information in one step. Accordingly, complexity has to be reduced by decomposing the difficult causes-effects cycles. HANISCH (2003), for example, divides the various stages of the property rights process into “sub-games” which can be understood as basic units of interaction embedded in an extensive political economy game. The contributions to property rights formation achieved by the interplay of actors at each level of the system can be interpreted as being “sub-game equilibrium solutions”. By means of “backward reasoning along the equilibrium path of action” (BATES et al., 1998: 239) explanations of the property rights process are constructed. These can be successively substantiated and gain in validity by employing the methodology of “analytic narratives” (BATES et al., 1998; GREIF, 1998; LEVI, 1998; WEINGAST, 1998; ROSENTHAL, 1998).

The main results achieved by the application of the theories and methodologies outlined above can be summarized in three points (HAGEDORN, 2000):

- “Efficiency and competition” as compared to “distribution and conflict resolution” and “ideology and mental models” are not the main driving forces of privatisation.
- “Privatisation” should not be conceived of as an isolated process of establishing merely private property rights, but the heterogeneity of property rights reform should be taken into account.
- “Shared mental models”, conceptions on innovation, learning processes and access to networks seem to be particularly important for institutional change which suggest that social capital deserves more attention in transition research.

These results will be explained in the following sections.

### **4.3 Driving forces of property rights reform**

The first point we have to make when talking about efficiency as a potential driving force of privatisation is that the meaning of efficiency itself depends on the presumed institutional environment and arrangements, for example in terms of distribution of actual income and entitlement to future opportunities. “Efficiency for whom?” (BROMLEY, 1989: 4) therefore is one of the main issues in the process of privatisation, because the institutional changes may favour the involved groups differently, for example, groups of reform-oriented politicians and the networks of the former nomenclature, former managers of state and collective farms or new private farmers and former state farm workers.

However, we could argue that privatisation does not necessarily mean inventing new institutions but just implementing a transfer of institutions well-known in many other countries. Since generally accepted definitions of efficiency are available then, the Theory of Exchange and Competitive Selection as an efficiency-oriented explanation for institutional change might be applicable (KNIGHT, 1992: 106). This approach includes two main aspects: economising on transaction costs as a motivation of actors in individual exchange, and competitive pressure as a selection mechanism for efficient institutions. The latter seems to be more important for our topic. However, the KATO privatisation studies provide only little support for this approach:

*At the level of central government*, in all countries under investigation direct institutional competition, i.e., the emergence of alternative concepts for land privatisation rules and their selection via the influence of factor or product markets, did not play a role, because these markets were still to be developed. Secondly, pre-institutional competition also did not become effective for various reasons that differed between the countries. In the Czech Republic, the policy arena was dominated by attitudes against former communism, and the structure of parties and their programmes were still not organised and failed to offer the citizens sufficient opportunities to express more detailed preferences by voting (SCHLÜTER, 2001). In addition, privatisation in agriculture did not enter the arena of general transformation policies and therefore did not become an issue that attracted the attention of voters. The choices were left to the policy network within the agricultural arena that made the policy choices dependent upon their bargaining capabilities and power resources.

In Bulgaria, the central government may sometimes be motivated to do what the rural electorate want them to do. However, all governments, which came into power after 1990, more or less failed to harmonise their concepts on land restitution and privatisation of farm collectives with the preferences and the needs of the voters in the rural areas. Instead, conflicting ideologies as a means to shape the profile of parties and the reputation of politicians dominated the decision making process. Most urgent reform problems – such as how to make ownership rights more secure, provide credit for private land users, to increase the machine capacity in the countryside, to organise markets, and to privatise the processing industry - were not seriously tackled. Even the revival of the co-operatives failed to create more sympathy among the rural electorate, as the expectations of people did often not fulfil, for instance when agricultural machinery was monopolised (HANISCH, 2003). Since the governments were also not able to communicate a convincing vision of Bulgarian agriculture to the rural electorate, the overaged rural population did not believe that the reforms would be able to improve their situation. Thus, a minimum level of trust and credibility, as a basic prerequisite of a democratic system was lacking and the elections did not become an

institution to control politics. Of course, this deficiency was reinforced by political instability resulting from changes in government and implementation staff.

In Poland, political circumstances were different from the other countries mentioned above for the following reasons: first, the protest movement, which started long before 1990, had already established a new and strong democratic tradition. Second, most of the land had remained in private hands during the socialist era, i.e., only state farms had to be privatised. Third, agriculture was divided into two groups<sup>5</sup> that were geographically and politically separated and had unequal resource endowments regarding the production of political influence. Although party competition and electoral control were sufficiently institutionalised, it did not play a major role for the choice of the privatisation strategies. This was due to lack of relevance of state farm privatisation for the electorate as a whole (MILCZAREK, 2002). Instead, the differences in lobbying capacities of the three main groups of stakeholders - the Peasant Party, the managers of former state farms, and former state farm workers – offer an explanation of the process and its outcomes.

At the *local level*, direct institutional competition also played a minor role. In the Czech Republic, for example, markets for restitution shares, buying and leasing land and services did not exist. Pre-institutional competition could be observed – a general assembly decided on the future legal form of a farm - but the resulting conflict was more or less dominated by the negotiation power of the managers (SCHLÜTER, 2001).

In Bulgaria, those who were successfully appropriating the scarce assets necessary to use land, such as machines and buildings, were also the most successful to appropriate the land. For this purpose, the former agricultural elite has often used practices which were far from competition-oriented behaviour or fair behaviour. For example, farm assets were supposed to be distributed in auctions by the land privatisation law, but this did not take place. Co-operatives often trade machine services for land. Rents are paid according to the willingness of the co-operatives, and in many cases lessees do not receive any payment. Even within the co-operatives, competition is not working as a selection mechanism, because general assemblies do not meet and take decisions, i.e. control of the management by the members is lacking (HANISCH, 2003).

In Poland, direct institutional competition was very limited although a land market evolved and, in principle, nationalised land was offered to all groups of farmers. However, the geographical distance between the majority of the farmers and the land

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<sup>5</sup> This is due to historical reasons. In the northern and western part of Poland there are three regions which formerly belonged to Germany (Pomerania, Silesia and East Prussia). After World War II, when they became Polish territory, mainly large state farms were established. In the other regions of Poland small family farms prevail.

offered by the Agricultural Property Agency (APA), non-co-operative strategies of the APA towards private farmers willing to buy smaller areas of land and restrictions on buying and leasing land, e.g., in auctions organised by the APA, were serious constraints.

If “efficiency produced by competition” is not the driving force of property rights reform, what else could be considered an appropriate explanation? The Theory of Social Conventions is not a convincing alternative. This approach implies the conception of salience (KNIGHT, 1992: 102), i.e. institutions are selected through the salience of focal points and established by repeated social interactions. This implies that “the rule evolves arbitrarily. The evolutionary process is unconsciously driven by whatever salient factor focuses the attention of the actors. The interest of any particular actor or group of actors does not determine the nature of the final institutional arrangement: that is, the distributional differences produced by different rules will not be invoked by the explanation” (KNIGHT, 1992: 102).

In contrast, the Theory of Bargaining and Distribution explains institutional change “as a by-product of strategic conflict over substantive social outcomes” (KNIGHT, 1992: 107). As pointed out in detail by SCHLÜTER (2001) and HANISCH (2003), this theory focuses on social interaction between actors seeking to achieve their distributional objectives. This is influenced by the differences in “action resources” the actors can make use of, such as information asymmetries between actors, education and skills, personal power, sanction power, credibility of their commitment, individual risk aversion, exit options, time preferences, etc. Although Knight only applies this approach to decentralised institutional change, most of its components also seem to be relevant to institutions that are centrally designed and are also treated by the Public Choice Theory of Institutional Change (WEIMER, 1997).

There are numerous empirical observations in the KATO privatisation studies that support this explanation. For example, in the Czech case the managers of former collective farms, due to their education, had better exit possibilities than the members of co-operatives and farm workers. Family farmers were more vulnerable by time-consuming negotiations than the managers, because they urgently needed assets to make their living. Similar differences were observed as regards credibility for being a successful farm manager in the future, the ability to organise as a group, and information asymmetries. The managers were endowed with positional power in the information network, because they were located between the local and the central level (SCHLÜTER, 2001).

In Bulgaria, the former agricultural nomenclature dominated for similar reasons in designing the changing organisation of farm production (HANISCH, 2003). However,

due to the particular situation in the country, which suffered from political instability and lacking democratic structures particularly in the rural society, the power asymmetries between actors were even more extreme and enabled the rural leaders to monopolise, e.g., land, machinery services, trade and processing activities.

In Poland, the managers of former state farms can also be considered as winners in the conflict over the distribution of nationalised land, because they could influence the bargaining process through power resources like information, skills from higher education, positional power and abilities to organise as a pressure group (MILCZAREK, 2002). In addition, they had better access to government agencies, credit organisations and advisory services than small farmers.

#### **4.4 Why “privatization” is no adequate conception of property rights reform**

However, these empirical observations not only reveal that the Theory of Institutional Change based on Bargaining and Distribution (including similar phenomena in political processes) offers better explanations than other approaches, but also shows that a process of privatisation driven by the desire of groups of actors having unequal power resources to appropriate “a piece of the cake”, often took place in a way that cannot be considered “efficient” for society. This questions a conception popular in economics that associates efficiency with private property rights and analogously suggests that “privatisation” in the sense of merely establishing private property rights is equivalent to increasing efficiency. “There is a need, ... , for a more careful consideration of institutions and of institutional change than a model that regards one particular institutional form (private rights) as universally responsible for economic efficiency, stewardship, and higher civilization” (BROMLEY, 1989: 18).

Property rights theory is often misunderstood as an approach explaining the definition and distribution of disposition rights focussing on physical entities (HAGEDORN et al., 2002). Strictly speaking, actors attribute (positive or negative) values to a physical good because the holder of the right is favoured by benefit streams or, in case of a duty, is burdened by cost components that are connected with the physical good. BROMLEY (1991: 189ff.) calls these nature components “countryside and community attributes”. A natural resource, like soil, is usually considered to carry only one homogeneous property title. However, such rights cannot only be classified according to the conventional division into (a) the right to use, (b) the right to alter and (c) the right of alienation. What is more, categories of property rights can be separately defined for numerous economic or ecological properties of the physical piece of nature, each of them related to particular costs and benefits. For each of these differentiated rights components, the institutional design of the right or duty can differ:

private, collective and state property regimes are imaginable, and also the absence of property rights definition in the sense of open access.

In addition, property rights on such attributes of natural or physical capital require adequate governance structures, because they must be supervised and sanctioned to become effective instead of only remaining formal in nature. The discrepancy between formal and effective property rights (see Section 3) is a well-known problem as a problem of privatisation in transition countries (SWINNEN and MATHIJS, 1997: 344). Those governance structures may not only consist of private ordering but also require collective or political arrangements.

In other words, concepts of property rights reform are only complete and consistent if

- all main attributes of a physical or natural object are subjected either to private property rights or other property rights regimes if these are superior, and
- governance structures for each component of this bundle of rights are developed, not neglecting the required political and administrative structures for decision making and implementation.

TORNELL (1999: 2), who calls the implementation of such additional restrictions to the opportunity sets of owners of privatised state owned enterprises “privatising the privatised”, mentions three conditions for complete privatisation: “First, re-establishing property rights within the firm, so that new owners enjoy full residual rights of control in their firm. Second, outside the firm, facing new owners with hard budget constraints so that they do not have the power to either extract fiscal transfers, or obtain bailouts. Third, establishing a non-corruptible juridical system, and transparent bankruptcy procedures that are free from political pressures”. When these preconditions are missing, reformers may hope that the “newly privatised firms will create a demand for good laws” (TORNELL, 1999: 2). However, this crucially depends on whether or not the firms consider such a demand actually as being in line with their interests, and secondly, whether or not the state is able to supply the legal framework regarding the political economy mechanisms involved. In well-established democratic systems this may be feasible, but in countries in transition it may be impossible.

The KATO privatisation studies provide many examples for the problems that arise if decision makers follow the above-mentioned misconception of privatisation. Thus, evidence was provided of the sanctioning of private farmers in the Czech Republic in order to keep their competitiveness and their reputation on the land market low. Another example was the monopolising of land, machine services and the processing industry in Bulgaria. The nature of this problem may be even better illustrated by the experience that privatisation concepts usually neglect environmental protection and ecological sustainability (GATZWEILER and HAGEDORN, 2003). Exhausting soil

fertility and destructing irrigation equipment during the process of restitution or privatising large livestock units without regulating manure pollution, etc. - all these practices show that property rights on nature components and corresponding governance structures were given low priority in the institutional reforms.

#### **4.5 Shared mental models and learning for institutional change**

When the centrally planned economies collapsed, the shared mental models (SMMs), which had been developed during the socialist era, could no longer fulfil their tasks. Individuals and groups depend on meaningful mental models for the purpose of reducing complexity (NORTH, 1990: 24). As a consequence, people were seeking new cognitive schemata to understand and to explain their changed world. In particular at the beginning of the transformation period, when the system in transition was characterized by a high degree of insecurity, reduction of complexity was urgently needed. Since this basic function of SMMs is of major relevance in this confusing situation, ideologies have played an important role in all countries under investigation. They provide people with plausible notions on how the world works and how it should work (NORTH, 1990: 28; EGGERTSON, 1993).

When old SMMs are not valid any longer and new ones are not available for the time being, individuals will of course resort to quite heterogeneous cognitive schemata. We must expect that there were extremely diverse mental models in society in the period that immediately followed the revolution, because a general consensus especially on normative principles had not been achieved yet. After a period of communication and consensus building, provided that this successfully leads to well-established SMMs, the latter may decisively help to reduce the cost of finding collective agreements on future institutional change (NORTH, 1988: 54). On early stages of the transformation process, the societies as a whole may not have arrived at sufficiently stable SMMs yet. However, these SMMs may have already existed within certain groups that are thus able to make use of their common understanding of problems and, in this way, can reduce their transaction costs of decision making and can achieve their particular group objectives more easily. Like institutions in general, SMMs serve as conceptions to structure human behaviour and to form and stabilise actors' expectations in social interaction. Above all, communication within groups is facilitated and requires fewer resources.

A SMM determines for a group what it conceives of as being its institutionally designed and, therefore, legitimate opportunity set. Such perceptions may substantially differ, for instance between a farmer, who has experienced forty years of socialist agriculture, and a farmer from the western world, who has operated a family farm for a similar period of time. One of the main features of an SMM is that it defines binding

constraints on the opportunity sets attributed to the members of various groups, thus determining many of their rights and duties. Hence, it does not come as surprise that the ability to shape people's SMMs proves to be an effective power resource in the bargaining process regarding new institutional arrangements.

This is particularly true if new mental models are required as a basis for new strategies. Privatisation studies have shown that there is obviously a variety of institutional choices for problems of institutional change, in general, and for transition, in particular. However, the mere fact that such solutions might exist will be of little practical use if actors or actor groups either do not know about the solutions, lack the creativity to find them, do not have sufficient resources to develop and to discuss innovations, are unable to communicate new institutional concepts in order to arrive at joint conceptions of the problems or are unable to organise collective action and participation of stakeholders. Collective learning processes combined with the evolution of new SMMs seem to play a fundamental role for institutional innovation.

The KATO privatisation studies have provided detailed empirical evidence for the relevance of SMMs. In the Czech Republic, for example, the debate about the Land Act at the national level was strongly influenced by ideological controversy being rather dogmatic in nature. One party, the "Democratic Citizens Party", which supported the restituteds, favoured the ideal of small family farms, simultaneously considering land as the main source of wealth. The other party, i.e. the "Social Democratic Party", preferred the conception of industrialised agriculture organised in large production units. Its considerations focused on labour and capital required to maintain and develop such large production units. The second party was clearly dominating at the local level, i.e. in the villages. For example, introducing a land rent to be paid to the landowners was perceived of as a strange phenomenon, even for the restituteds, and had to be fixed in the law.

In Bulgaria, up to now no reconciliation of the contradicting SMMs preferred by the competing parties has been achieved. This has repeatedly led to radical changes of the fundamental principles of privatisation between "The Red" and "The Blue" - these colours reflect the two main political groups<sup>6</sup>. Even in the villages this division in "The Red" and "The Blue" has strongly shaped the rural society, and even regions and villages can be classified according to this political distinction. Being red or blue has proven to be an important determinant of the privatisation process.

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<sup>6</sup> The "Reds" are the members of the "Bulgarian Social Democratic Party" which is the successor of the former communist party. The "Blues" belong to the "Union of Democratic Forces", a new party which represents the proponents of social and economic reforms.

Poland has undergone a much longer period of transformation than the other two countries. The Polish society has been fundamentally shaped by the reform movements which started long before 1989. As a consequence, discrepancies regarding SMMs may be less relevant here. However, the question arises to what extent such conceptions do account for the dualistic structure of Polish agriculture with large farms operating on formerly nationalised land, on the one hand, and small family farms whose structure has been more or less frozen by the socialist system, on the other. Obviously, the dominating perception of this problem does not sufficiently reflect the opportunity to use privatisation of state-owned land for the structural improvement of the family farm sector.

Unfortunately, our knowledge on how SMMs evolve and how they influence institutional change is rather limited. How this kind of knowledge can be increased is shown by the excellent work of VERDERY (2003) on land distribution in Romania. In her study she characterised the relations between locals (who received land) and venits (who have not got land). She cites, for example, a venit who replied to the offer of a local to “sharecrop land for him, ‘We won’t work for you ‘aristocrats’, *for chiaburs*’. Working for the collective was one thing, and it ought to entitle them to land, but working for locals was something else again. I heard the same idea in discussing with venits how they thought they would get by without land if they lost their factory jobs. ‘Will you sharecrop for the people with land?’ I asked, receiving the following kind of answers, always in a heated tone: ‘We don’t want to be serfs for the local nobles!’ ‘I am not going to make *someone else* a gentleman!’ ‘You think I look like a servant? People with lots of land are waiting for us to come and support them while they rest in the shade. Some people here have 20 ha, while others have none at all. If we go and work for them, it will be just like the days of serfdom! No way!’ “ (VERDERY, 2003: 175f., italics in original).

## **5. Social capital as a bottleneck in the transition process: the need for further research**

Many of the results pointed out above are related to phenomena like trust or opportunism, shared mental models and the properties of networks of actors. This supports the hypothesis that both the quantity and the quality of social capital in transition processes are for the success of transformation. The autocratic political design of the communist governments tried to avoid peoples' free participation in public affairs, requiring a process of learning and reorientation as an essential part of reform in those societies. Societies will only be able to cope with such demanding and sometimes disappointing changes if sufficient social capital will be accumulated (OSTROM and AHN, 2003).

As a result of the historical development of their societies and their personal experience in their respective countries, people are differently predisposed to form relationships with one another. “This depends on social norms and the prevailing social structure. Within the CEE, the presumption of low levels of social capital is explained in the literature either by: an increase in general mistrust brought about by experiences within a planned economy (SWAIN, 2000); the dictatorship theory of missing social capital (PALDAM and SVENDSEN, 2000) which eroded or destroyed voluntary cooperative engagement, and when individuals associated their political leaders with corruption and merely having self-serving interests (LANG, 1999); an increase in mistrust brought about by the ‘grabbing’ strategies that emerged from certain individuals in the period immediately after new institutions were rapidly introduced in the early 1990s (SIK and WELLMAN, 1999); or a high reliance on family and kinship networks in countries with ‘weak’ formal institutions (THEESFELD, 2003; GREIF, 1994). All these factors impose constraints on the formation of social capital in the post-communist states. At times, they have resulted in a break down in communal spirit by the move to a more market-oriented economy, leading to a loss of trust and an increase in opportunism.”<sup>7</sup>

PALDAM and SVENDSEN (2000) have pointed out that social capital deteriorated during the socialist era and has not sufficiently accumulated during the transition process as well. Weakness of non-profit organisations and lack of trust as a prerequisite for collective action can be considered as important indicators for such deficits in social capital (ROSE-ACKERMANN, 2001). Similarly, several case studies conducted in the frame of the CEESA project<sup>8</sup> (GATZWEILER and HAGEDORN, 2003) revealed that property rights reform, agricultural restructuring, political decision making and implementation, and the management of natural resources often suffer from a lack or an unfavourable nature of social capital. THEESFELD (2003: 263-268; 2005), for example, impressively illustrates this phenomenon by her analysis of the transformation of the Bulgarian irrigation system. Her results show that rural citizens have “almost no trust in the parliament, the government, the courts (0%), and the district administration. The trust in local authorities is higher than in any of the formal authorities at the national level, but, in general, it is low in both. Interestingly, trust in the mayor is even lower than trust in the police, both being the only two formal authorities representing the state at village level. ... Only trust in the ‘blue’ cooperative reaches a share of over 50%. ... a share of 46% of the interviewees does not trust any authority at the national level and 19% do not trust any local actor”

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<sup>7</sup> See MURRAY (2004) who presents an overview of “Social Capital and Cooperation in Central and Eastern Europe – A Theoretical Perspective”.

<sup>8</sup> CEESA = Central and East European Sustainable Agriculture, EU project in the Fifth Framework Programme coordinated at Humboldt University Berlin.

(THEESFELD, 2003: 264). Similarly, the majority of members of the parliament, especially of court members, are considered corrupt by the citizens. "... 26% named the mayor, 33 % the water guard and 43% the 'red' cooperative manager as corrupt" (THEESFELD, 2003: 264).

Such deficits regarding social capital may act as serious obstacles against institutional innovation, in particular introduction of cooperative arrangements or self-organised mechanisms of conflict resolution as well as co-production and co-management between government agencies and social groups in policy implementation. However, there is still too little knowledge on the structural properties of social capital, the relationships between its elements and the causalities behind its changes. Accordingly, reliable concepts of how social capital can be intentionally built are still lacking. There is urgent need for empirical research contributing to the development of the theory on social capital and enabling policy makers and other actors to support accumulation of social capital.

## 6. Conclusions

Anyone who intends to give recommendations regarding the future "design" of the transition process should be aware of the limited opportunities of politicians and administrators to influence such processes of institutional change. This holds especially true for external actors, such as the EU, neighbouring countries or international organisations, as foreign aid experiences have also shown (see, for example, OSTROM et al., 2001). Furthermore, we have to keep in mind that many decisions on privatisation and restructuring have not only been made long before but have been frequently revised as well. Consequently, the main task is to re-orient past implementation procedures and decisions in order to achieve stability of land policy and reliability of land institutions and cope with the consequences of past inadequate decisions and undesired outcomes of implementation processes.

Recommendations solely focussing on new policy instruments or technical solutions (for example, reducing land fragmentation by land consolidation schemes) may produce adverse effects if they are not able to predict how they will affect rent-seeking strategies and power resources of the main actors involved. Deficiencies in actors institutional structures, e.g., their political property rights and their governance structures, may provide only ineffective constraints against opportunistic behaviour. For such reasons, the institutional pre-requisites of proper decision making and implementation processes should be prioritised, investigating the relationships between proposed policy instruments and the emergence, strengthening or weakening of democratic and participatory institutions. As the political and administrative systems are often imbalanced and sometimes suffer from corruption, the support of

self-organisation may contribute to a more balanced power structure, more pluralism and increased participation. Thus, it may help to create more security for economic actors, e.g. farmers, who hesitate to invest into their enterprises.

Of course, this requires, first of all, a well-functioning administrative system. From the perspective of external agencies, it is very important to extend and to improve implementation capacities as regards monitoring and enforcement. However, it is equally important that such systems do not only serve the interests of state hierarchies (or international organisations), but would also be rooted in the rural society and would enable rural people to participate in and contribute to processes of decision making and implementation. Building social capital in the rural society is of fundamental relevance for land reforms and land policies. This may be even more relevant for regions with major conflicts among groups, which may have unequally benefited from the privatisation process, particularly when such conflicts have an ethnic component.

External decision makers should not exclusively interact with the administrative and professional elites, but pay attention to the involvement of rural people. Particularly in transition countries, policy processes and policy results look different at the various levels of decision making and implementation. Monitoring and communication concepts should reveal on-site findings and should elucidate whether people are actually provided with access to information, policies, common pool resources, extension services, and the legal system. Special attention should be paid to the problem of postponing tasks of the transformation process, which are not immediately profitable, in favour of other tasks that offer private benefits, such as economic profits or political positions. The former, for example, applies to cultural and environmental values. Generally, any land policy has to be aware of the fact that land and other natural resources are complementary both in economic and ecological terms.

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