

EFFICIENCY OF FARMS AND AGRARIAN ORGANIZATIONS

This paper incorporates achievements of the New Institutional Economics and suggests a framework for assessing efficiency of farms and agrarian organizations. The new approach includes: study of farm and agrarian organizations as governing rather than production structure; assessment of comparative efficiency of alternative market, contract, internal, and hybrid modes of governance; analysis of level of transaction costs and their institutional, behavioral, dimensional, technological and natural factors; determination of criteria of farm efficiency and its effective boundaries; specification of economic role of government and needs for public interventions in agrarian sector; assessment of comparative efficiency of alternative forms of public involvement in agrarian sector.

JEL: Q01, Q12, Q13, Q15, Q18

Around the globe the assessment of efficiency of farms and agrarian organizations is one of the top issues in the discussions of researchers, farmers, investors, politicians, and the public at large.¹ This problem has also been thoroughly debated in Bulgaria during the period of transition and European integration.²

Unprecedented development in the theory of economic organisations in the past decades has brought about to a significant evolution in understanding of essence and efficiency of agrarian organisations as well³. Nevertheless specific and partial approaches for assessing the efficiency of farms and other economic organisations in agriculture are predominately used. Efficiency of agrarian organizations is usually evaluated (only) through „technical efficiency” of production factors and “productivity of employed resources”. Comparisons are made of levels of efficiency across farms of different type, sectors and countries independent to the

¹ Gortova, M. and S. Davidova. Farm productivity and efficiency in the CEE applicant countries. Elsevier, 2003; Harvey, J., P. Klein and M. Sykuta. Markets, Contracts, or Integration? CORI, 2007; Mathijs, E. and J. Swinnen. Production Organization and Efficiency during Transition. PRG, 1997; Masterson T. Productivity, Technical Efficiency, and Farm Size in Paraguayan Agriculture. Levy Economics Institute, 2007; Sporleder, T. Managerial Economics of Vertically Coordinated Agricultural Firms. - American Journal Agriculture Economics, 1992, 5, p. 1226-1231.

² Zaimova, D. Methods of Assessment of the Economic Efficiency of Farms – Economic Thought, 2011, N2; Ivanova, N. Economic Efficiency of Bulgarian Farms, specialized in the production of grain, grapes and vegetables. – Economics and Management of Agriculture, 2009, N 2, p. 51-61; Koteva, N. Economic Efficiency of Farms. Economics and Management of Agriculture, 2011, N 1; Kanchev, I. and J. Doychinova. Comparative Analysis of the Functioning Private Organizational Structures in Sector Agriculture, UNWE, 2000.

³ Bachev, H. Efficiency of Agrarian Organizations. - Farm Management and Rural Planning, 2004, N 5, p. 135-150; Harvey J. and M. Sykuta. Property Right and Organizational Characteristics of Producer-Owned Firms. - Annals of Public and Cooperative Economics, 2005, N 4, p. 545-580.

specific economic, institutional or natural environment of their development. Not corresponding to the real world “ideal” models and sizes of “effective” (livestock, greenhouse) enterprises are recommended based on optimized technological factors of production and/or experiences in other regions and countries. On the other hand, the other agrarian organizations (contracts, associations, markets, public forms) are not considered alternative structures but ignored or studied separately.

In more sophisticated models of the Neoclassical Economics the criteria for assessing efficiency of an organization is derived from the equilibrium condition of the entire economic system – when marginal income is equalized with the marginal costs.⁴ According to such simplified understanding of the economy the entire activity of agents is governed by a single free market mode. Organizations using resources with different (higher, lower) from marginal productivity are inefficient. The rare cases of “market failure” (tragedy of commons, externalities) are easily detected and timely corrected through “perfect” government intervention.

Traditional approach for assessing economic organizations can not give answer to the question: *why there are so many organizations performing with a great variation in efficiency* for a long period of time. For instance, all analyses show a high sustainability of “inefficient” organizations in Bulgarian agriculture - unproductive (semi)market farms, production cooperatives with profitability several times lower than private farms, sub-sectors with “return on resources” bellow the agricultural average, inefficient contractual and vertically integrated arrangements, not-working public organizations.⁵ If efficiency of a particular organisation is low, there will always be a strong private or public mechanism (competition, public intervention) for reallocation of resources to more effective application, and in the long run there will be only “effective” organizations governing resources on (close to) socially acceptable level of efficiency.

The traditional approach estimates and compares levels of efficiency of different organisations without even looking for answering the question: *why there is such a variety of organizations* in a country, sub-sector of agriculture, geographical region etc. - one-person farms, group farms, registered cooperatives and firms of different kind, associations and joint ventures, subsistent farms, part-time and full-time farms, small and large farms, contractually or fully-integrated forms, hybrid (public-private) organisations. Therefore, in the narrow framework of approach restricting efficiency of economic organisations to production costs, it is neither possible to understand the economic logic of diverse agrarian organisation nor to assess their comparative efficiency and complementarities.

⁴ Pigou A. Economics of Welfare. London: Macmillan and Co., 1920.

⁵ Ivanova, N. Op. Cit., p. 51-61; Koteva, N. Op. Cit.; Bachev, H. Management of Farm Contracts and Competitiveness. VDM Verlag, 2010.

This paper incorporates achievements of the New Institutional Economics⁶ and suggests adequate framework for assessing the efficiency of farms and diverse economic organizations in agriculture. The goal is to understand the role, factors, and efficiency of agrarian organisations, as well as to assist organisational design of farms, collective actions of agrarian agents, and public policy in the sector.

Agrarian organizations as a governance structure

Newly developing methodology of the *New Institutional Economics* explains the concepts of diverse economic organizations with their role to *govern relations between individual agents and to minimize transaction costs*. Carrying out agricultural activity and related exchange (land and labor supply, financing, marketing of output) is usually associated with significant (transaction) costs. For instance, there are costs for complying with institutional requirements (laws, standards, informal norms), finding best prices and partners; negotiating conditions of exchange; contract writing and registration; enforcing negotiated terms; dispute resolution (including through court or another way); adjusting or termination along with evolving conditions etc.

Division and specialization of labor, and related exchange and cooperation, open up enormous opportunities for increasing productivity and welfare. They create possibilities and incentives for deepening specialization and exchanges. However, they are also associated with additional transaction costs. The high of costs for external exchange make it more profitable to carry out division and cooperation of labor (a transaction) within a certain organization (firm, group farm) instead across the market. For instance, a specialized livestock farm organizes internally a crop production activity (hiring additional labor, farmland) because of significant costs and risks for market procurement of forage. Internal management of transactions is also associated with costs (for directing, stimulating and supervising hired labor; coordination and controlling partners activity) which restricts unlimited expansion of borders of (internal) organization. Thus *a transaction (activity) will be carried in an organization if the costs are lower than for governing that transaction across market or in another organization.*⁷

Usually, every agrarian activity and exchange could be governed through a great variety of *alternative* forms.⁸ One extreme for the farm manager is to specialize exclusively in governing of market transactions (rather than production management)

⁶ Coase, R. The Nature of the Firm. – Economics, 1937, 4, p. 386-405; Furuboth, E. and R. Richter. Institutions and Economic Theory: The Contribution of the New Institutional Economics. Ann Arbor. The University of Michigan Press, 1998; Williamson, O. The Mechanisms of Governance. New York: Oxford University Press, 1996.

⁷ Coase, R. Op. Cit., p. 386-405.

⁸ In agriculture it is almost impossible to give examples where the organizational form is unilaterally (pre)determined by technology, and with the same production technology many forms of organizations are possible.

- leasing-in farmland and long-term tangible assets, purchasing all services for cultivation and harvesting of output, buying needed short-term tangible assets, selling all primary products on the market. Another extreme is a close one-person or group farm – the farmer(s) employ only own resources and labor, and consume the entire product. Between these two poles there is a spectrum of feasible modes for governing of agrarian activity and exchange. For instance, “cultivation of land by a tractor” can be governed in numerous ways: the farmer can buy (one-person ownership), rent (rent contract) or lease a tractor (input and credit supply interlinked contract), and use it for cultivation of land; the farmer could buy once or multiple times cultivation service from market (spot-light or long-term service contract); a group of farmers may buy jointly a tractor (joint ownership) and use it in a group (producers cooperative) or individually; the farmer can join a cooperative providing cultivation services (non-for-profit organization); the farmer may lease the land out to a tractor owner and share the output (tenancy contract with fix or share rent); the farmer can hire a tractor driver to work on farm (employment contract), and may even sell out the cultivation service (profit-making organization); the cultivation services to farms could be subsidized by the Government (trilateral mode), or provided by a municipality or a state company (public organization) etc. Depending on comparative efficiency of practically possible forms preference will be given to one or another organisation of activity/exchange.

Consequently, distribution of overall activities among different farms, agrarian organizations, and markets will be determined by comparative costs for using various governing arrangements as *the most efficient one(s) minimizing the total (internal and external) transaction cost will prevail* in the long run. The economic efficiency of farms and agrarian organizations should take into account not only their capacity to minimize production costs, but also their ability to economize on transaction costs. While the production costs are cost associated with proper technology (“combination of production factors”) of certain farming, eco-conservation etc. activity, the transaction costs are costs for governing relations between individuals (for adaptation to institutional restrictions, coordination of activity, protection and exchange of various rights etc.). Moreover, both (*current*) costs for using individual organizations and *long-term* costs for their development (initiation, maintenance, modernization, liquidation) have to be taken into account.

If the execution of activity and exchange were not associated with transaction costs (“zero transaction costs”) then the mode of organization would have no economic importance.⁹ The individuals would govern their relationships with same efficiency though free market (adapting to price movements), and private modes of different types (contracts, firms), and collective decision-making (cooperative, association), and a nationwide hierarchy (single private/state company). Then the

⁹ Williamson, O. Op. Cit.

technological opportunities for economies of scale and scope for production of socially needed products and services (maximum productivity of resources, “internalization of externalities”) would be easily achieved.¹⁰ All information for the effective potential of transactions (optimization of resources, meeting demands, respecting rights and rules) would be cost-free available to everybody, and individuals would cost-free define new rights, and protect absolute¹¹ and contracted rights, and trade (exchange) owned resources of mutual benefit until exhausting possibilities for increasing productivity and welfare (“Pareto efficiency”).

However, often the high transaction costs make it difficult or even block otherwise efficient (mutually beneficial) for all parties activity and exchange. For instance, despite the high pay-off of investments in agrarian research and innovation, the market and private agents do not organize (at all, in a socially desirable scale) such activity/transactions because of the high uncertainty and low (market and private) appropriability of investment.

Since the agrarian activity is connected with transaction costs, the “rational” agents will seek, chose, and develop modes of organization of activity and exchanges which *maximize transacting benefits* and *minimize transaction costs*. The type of economic organization is crucial since various governing modes give unequal possibilities for participants to explore social and technological opportunities (meeting demands, economies of scale and scope, non-separability of activity), coordinate and adapt transactions, stimulate acceptable behaviour of counterparts, control and protect from unwanted expropriation investments etc. In the long-run inefficient forms will be abandoned and only effective modes for organization of agrarian activity and exchange will dominate.

Each activity and transaction has different specific characteristics varying according to the institutional environment (legislation, efficiency of public enforcement of laws and private contract, other formal and informal restrictions), personal characteristics of agents (preferences, accumulated experience, established reputation, tendency for opportunistic behavior, risk aversion), macroeconomic conditions (economic stability, foreign trade regime, available state support), dominant technologies (mechanization and standardization of operations, application of information technologies), and natural environment (recourses endowment, dependency). There is no single most efficient form for organization of all agrarian activity and transactions in all practically possible economic, institutional and natural settings. According to the critical dimensions of activity/exchange the agrarian agents will use the most appropriate (effective) mode for governance. In any particular moment the entire agrarian activity and allocation of resources will be carried out (governed) through a *great variety* of economic organizations: part of it

¹⁰ Coase, R. The Problem of Social Costs. - Journal of Law and Economics, 1960 3, p. 1-44.

¹¹ Formal and informal rights of individuals, groups, and generations defined by the institutional environment.

will be within a classical one-person farm (firm), another part will be managed through a special contract modes ("private order") between independent partners, the third part be coordinated by the movement of market prices and market competition ("invisible market hand"), part will be organized through collective decision-making (partnership, cooperative), another part will be managed internally by a manager or more complex hierarchical structures, some will be supported by a third party (Government, international assistance), or would require more complicated and hybrid modes.

Transaction costs minimizing "logic" helps us understand the evolution and efficiency of modern agrarian organizations – the dynamics in development and potential of diverse type of farms (subsistent, semi-market, group, for profit or not for profit orientation, corporate) and coalitions; economic horizontal and vertical boundaries of farms (extension of internal division and specialization of labor, product diversification, decisions to "make or buy", "sell or continue processing", "buy or rent", "organize production or transfer-out user rights on resources); diverse kinds of contracts (classical, neoclassical, trilateral, long-term, interlinked) for supply of land, labor, services, resources, innovation, finance, risk management, marketing; economic needs for cooperation with competitors (in inputs supply, marketing, environmental conservation, lobbying) or vertical (downstream, upstream) counterparts; forms of management of natural resources and eco-system services; pace and limits of development of agrarian and related markets; needs for and efficiency of state and/or international intervention etc.¹²

What is more, efficiency of particular organization can hardly be assessed without analyzing efficiency of complementary and/or competing organization(s). For instance, "high" efficiency of small-scale farms and producers (inputs supply, marketing) organizations in most countries can not be properly evaluated without analyzing their high complementarities. Furthermore, depending on dominating public organizations (public provision, support, preferences), individual market and/or private organizations would have quite dissimilar efficiency for different agents.

In addition, efficiency of a particular organization can not be properly assessed without analyzing the efficiency of complementary and/or competitive organization/s. For instance, the "high" efficiency" of numerous small (and domestic) farms and production cooperatives during the post-communist transition period in Bulgaria can hardly be properly evaluated without analyzing their high complementarities.¹³

According to the dominant institutional environment (distribution of formal and informal rights and obligations between individuals and groups, and efficiency of

¹² Analysis of efficiency of agrarian organizations during the period of transition and European integration in Bulgaria is done by *Bachev, H.* Management of Farm Contracts and Competitiveness...

¹³ *Bachev, H.* Governance of Agrarian Sustainability, New York: Nova Science Publisher, 2010.

enforcement of “rules of the game”) and the forms of public involvement (state provision, assistance regulation), the individual market and/or private organizations will be with quite dissimilar efficiency for different agents and sectors. For instance, in transitional conditions of not well-defined and assigned private rights on farmland, and the high costs for their protection and exchange, the short-term lease and the internal integration (subsistence and semi-market farming, production cooperation) were the most efficient forms for organization of land supply in Bulgarian agriculture. Therefore, specific institutional environment, in which economic activity is carried out, is the *key parameter*, which eventually (pre)determines the type and pace of socio-economic development of a particular social group, region, sector of economy, country etc.¹⁴

Thus in the real world with incomplete and not-well defined and enforced rights, and positive transaction costs, the farm and other agrarian organizations have a *significant economic role*. Farms are not only production but a major governance structures – the forms for organization of transactions and for minimization of transaction costs. The efficiency of different types of farms can not be properly understood and assessed without analyzing their comparative production *and* governance potential. The largely applied Nirvana approach should be abandoned for evaluating organizational forms as “good” or “bad” for their own, or on the basis of a specific (technical, distributional, financial, ecological) type efficiency, or in a comparison with some non-feasible (ideal, institutional and transaction costs free, in other countries etc.) model. The evaluation should focus on finding out the comparative advantages for initiating, establishing, using, management, adaptation, intensification, coordination, stimulation and controlling of the alternative and really possible modes of governance in the specific market, institutional, technological and natural environment.

Factors for choice of organizational form

Individual forms of governance have specific *advantages* and *disadvantages* for protection of rights of participants, and coordination and stimulation of socially needed agricultural activity (production of food and feed, materials for industry, environmental conservation etc.). They are alternative but not equally efficient modes for organization of individual activity/transactions since they have different features (advantages, disadvantages) to coordinate, control, and stimulate (maximize benefits from, minimize costs of) transactions.

The free market has big coordination and incentive advantages (“invisible hand of market”, “power of competition”), and provides “unlimited” opportunities to benefit from specialization and exchange. However, market governance could be associated with high uncertainty, risk, and costs due to lack of adequate information,

¹⁴ North, D. Institutions, Institutional Change and Economic Performance. Cambridge University Press, 1990.

price instability, possibility for opportunistic behaviour, “missing market” situation etc.

The special contract form (private ordering) permits better coordination, intensification, and safeguard of activity/exchange. However, it may require large costs for specification, writing down and registration of contract provisions, controlling contract implementation, adjustments with constant changes in conditions, enforcement and disputing of negotiated terms etc.

The internal (ownership) organization allows greater flexibility and control on activity (direct coordination, adaptation, enforcement, dispute resolution by fiat). However, extension of internal mode beyond family and small-partnership boundaries command significant costs for coalition (finding partners, design, registration, restructuring), and current management (collective decision-making, control on coalition members opportunism, direction, supervision and motivation of hired labour). *The separation of the ownership from the management* (cooperative, corporation) gives enormous opportunities for growth in productivity and transacting efficiency – internal division and specialization of labor; exploration of economies of scale and scope; introduction of innovation; diversification; risk sharing; investing in product promotion, brand names, relations with counterparts and authorities. However, it could be connected with huge transaction costs for decreasing information asymmetry between management and shareholders, decision-making, controlling opportunism, and adaptation. *The cooperative and the non-for profit form* also suffers from low capability for internal long-term investment due to non-for-profit goals and non-tradable character of shares (horizon problem).

Which one of the principle forms of organisation of activity and transactions will be used depends on comparative efficiency (transaction costs) of practically possible alternatives. The transaction costs have two *behavioral* origins: *individual's bounded rationality* and *opportunism*.¹⁵ Agrarian agents do not possess full information about the economic system (price ranges, demands, trade opportunities, development trends) since collection and processing of such information is very expensive or impossible (multiple markets, future events, partners intention for cheating). In order to optimize decision-making they have to spend costs for “increasing their imperfect rationality” - data collection, analysis, forecasting, training, consultation.

Economic agents are also given to opportunism and if there is an opportunity for some of transacting sides to get non-punishably extra benefit/rent from exchange, they would probably take advantage thereof. Three major forms of opportunism can be distinguished: *pre-contractual* (adverse selection) - when some of the partners use the “information asymmetry” to negotiate better contract terms; *post-contractual* (moral hazard) - when some counterpart takes advantage of

¹⁵ Williamson, O. The Economics of Organization. - The American Journal of Sociology, 1981, 87 (3), p. 548–577.

impossibility for full observation on his activities (by another partner, a third-party) or when he takes “legal advantages” of unpredicted changes in exchange conditions (costs, prices, formal regulations). The third form (free ride) occurs in development of large organizations where individual benefits are not-proportional to individual efforts (costs). The trend is everyone to expect others to invest in organizational development, and benefit from the new organization in case of a success.¹⁶

It is often very costly or impossible to distinguish opportunistic from non-opportunistic behavior because of the bounded rationality of agents (e.g. farmer finds out that purchased seeds are not high quality only during harvesting time). Agrarian agents have to protect their rights, investments, and transactions from hazard of opportunism through: ex-ante efforts to find reliable counterpart and design efficient mode for partners credible commitments; and ex-post investments for overcoming (through monitoring, controlling, stimulating cooperation) of possible opportunism during contract execution stage.¹⁷

Besides the transaction costs, the choice of economic organization also depends on a number of additional important factors:

First, personal characteristics of individual agents – preferences, ideology, knowledge, capability, risk-aversion, reputation, trust, “contractual” power. For instance, farming organization is often restricted to a family partnership; in some cultures, the cooperative is the preferred mode of agrarian organization. If the farmer is a good manager he will design, control and run a bigger (more effective) organization adapted to his specific needs – to manage effectively more internal (hired labor) and outside (market and contract) transactions. A risk-taking farmer prefers risky but more productive forms - e.g. bank credit for a new profitable venture. When counterparts are family members or close friends there is no need for complex organization since relations are “governed” by the high mutual confidence, good will, and common interests of parties. Benefits for farmers could take different forms: monetary or non-monetary income, profit, indirect revenue, pleasure of self-employment or family enterprise, enjoyment in agriculture, desire for involvement in environment or heritage preservation, increased leisure and free time, other non-economic benefits.

Second, institutional environment - formal and/or informally imposed social order (“rules of the game”) and associated costs. Often the choice of governing mode is (pre)determined by the institutional restrictions as some forms for carrying farming activities, land and labor supply, trade of output etc. could be socially unacceptable, too expensive or illegal. For instance, corporate and cooperative organization of farming is forbidden in many countries; market trade of farmland, natural resources, and some products/resources is illegitimate, private

¹⁶ Olson, M. The Logic of Collective Actions: Public Goods and the Theory of Groups. Harvard University Press, 1969.

¹⁷ Williamson, O. The Mechanisms of Governance...

management of natural ecosystems is not allowed; some type of farms, agrarian property or transactions are with preferential tax regime. However, if costs associated with the illegitimate governance is not high (possibility for disclosure low, enforcement and punishment insignificant) while benefits are considerable, then the more effective modes prevail – large gray or black economies are widespread around the globe.

The (external) institutional environment considerably affects the level of transaction costs and thus the choice of economic organization. For instance, in the recent years thousands of Bulgarian farms and organizations have been closed due to impossibility to adapt to new EU standards for quality, safety, environmental preservation, animal welfare etc. Actually, under the conditions of stable and well-functioning public regulation (regulations, quality standards, price guarantees, quotas) and effective mechanisms for laws and contract enforcement, a preference is given to spotlight and classical/standard contracts. When rights on major agrarian resources (lands, waters, tangible assets) are not well defined, and absolute/contracted right is effectively enforced, primitive subsistence farming, personalized and over-integrated forms, unsustainable organizations, undeveloped and missing markets prevail.

Third, natural and technological factors like non-separability and interdependency of activity, technological economies of size and scale etc. In rare cases there is *only one* practically possible form for governance of agrarian activity. For example, the natural minimal size of farming organisation is determined by a technological parameter such as non-separability of activity (e.g. biological non-separability of individual animal). In Japanese dispersed paddy agriculture water supply could not have been conducted by individual farmers (high interdependency, non-separability of water use) and since earliest period water use organization developed as a public project.¹⁸ The effective governance of some environmental activities also requires a certain scale and thus collective actions at local, regional, national or transnational scale. However, beside these few examples, in farming it is almost impossible to find cases where the form of governance is unilaterally determined by the technological parameters.

Another technological factor, which can determine the form of governance (type and size of the farm) is the possibility to explore technological economies of size and scale. For instance, in order to use a large harvester-combine the farmer extends the farms size, or produces two or more products with different technologies in order to utilize “free” resources (family labor). Generally, development of technology follows the demand in the sector and in fact is also a variable parameter.¹⁹ What is more, maximal scale economies could be achieved not through internalization of activity but

¹⁸ Mori, T. The History of Japanese Agriculture. – In: Agricultural Policy in Japan, IAAE Conference, Tokyo, 1991.

¹⁹ Otherwise the wide spreading of “small” machinery in agriculture is very difficult to explain.

though market exchange of specialized activity – e.g. selling out or purchasing a service “harvesting with a combine”. Free resources of the farmer could also be traded (sold, leased-out) more effectively on the market instead of being used in own non-specialized activity (opportunity costs rule).

Actually, we can observe the opposite tendency – dependence of technological development on the governance structure. It is typical when the institutional restrictions (land transfer, hiring labor) and the high transaction costs (for outside financing/crediting) restrict the realization of the potential of available technologies. Widespread application of primitive technologies is a rule rather than an exception in the agrarian sector. In other cases, the high transaction uncertainty or imperfect institutional arrangements lead to expansion of farm organization beyond the “technologically optimal” scale. In Eastern Europe there was a common “over-concentration” during the communist period, and “over-integration and cooperation” in the following years of transition.

The technological development affects enormously the structure and the level of transaction costs. Mechanization and standardization of operations and products increases the manageability and leads to extension of activities under a single management enlarging internal (internal division and specialization of labor) and external (market and contract procurement, trade, cooperation) transactions. Possibilities that progression of modern production, transportation, measurement, communication etc. technologies gives to coordinate and intensify transactions and minimize costs are immense - easy assessment and traceability; on-line information, coordination, monitoring, detecting, advise; direct low costs exchanges and collective actions of interested agents at national and international scales; rapid detection of problems and interventions by the government; full participation of individuals in and control on public decision-making etc.

Farm efficiency criteria

The better understanding of the essence of agrarian organizations let us resize the criteria for economic efficiency of the farms as well. The “immediate combination” of the factors of production in agriculture will have to be carried out in such forms which optimize (minimize) the total production and transaction costs of participants. A farm will be efficient if (it has a potential to) realize *maximum possible productivity of resources with minimum transaction costs*. According to that an increase in efficiency of an enterprise means improving productivity with the same transaction costs or decreasing the transaction costs for achieving certain productivity. The (maximum) efficiency of the farm is achieved when the potential for increasing productivity of resources is realized with the minimum transaction costs compared to practically possible alternative organization.

Often, the alternative organization of the farm (commercialization of internal transactions, transformation of one-person farm/firm into a coalition) is obviously

more efficient since it increases the overall technological and transactional benefits with less overall costs (economies of scale and size). However, if changing the organization is associated with additional production benefits (reduction of production costs, growth in productivity and quality) at the expense of additional transaction costs (management of a contract for finance supply, innovations and services, hiring labor), then the new organization will be efficient if there is a *net benefit* – *when the benefits in the form of growth in output, income, free time etc. are bigger than the growth of transaction costs.*

Methods for assessing the partial and overall productivity of resources (productivity, profitability, measurement of current and capital costs etc.) are well elaborated. What is a challenge is the “measurement” of transaction costs. One direction for assessment is the *direct* comparison of costs for each transaction in different forms, as organization which requires less costs is more efficient. For instance, a comparison is made whether own marketing of output is more beneficial or it is cheaper to use a marketing cooperative.

Sometimes, the costs of transaction are easily determined since they are object of separate accountancy or can be easily specified. For instance, costs for registration, agro-market information, advertisement, court suits, guarding property, payment of bribes, (part of) losses from ineffective transactions (thefts, cheating, failed product) could be quite precisely specified.

However, some of the transaction costs are difficult (very expensive) or impossible to be determined. This group includes the costs for finding the best partner, negotiation, enforcement of contractual terms, organizational development, interlinked transacting, unrealized and failed deals. It is often complicated to separate transaction costs from the traditional production expenditures²⁰ – e.g. while executing farming operations a farmer supervises hired labor; during inputs transportation he negotiates marketing of output. Approximate estimate for the level of transaction costs could be made by interviewing farm managers where they indicate the level (high, middle, low) of efforts/time devoted for governing different type transactions: for finding needed labor for hiring, land and material inputs for purchase and lease; negotiating terms of exchange; monitoring implementation of contractual obligations; adaptation of contracts to new conditions; conflicts resolution; memberships in professional organizations; relations with agrarian bureaucracy etc.

The detailed comparison of transacting costs could not always give an idea for the efficiency of organizations since often the alternative form decreases one type of costs while increasing another type of transaction costs. For instance, internalization of a transaction (replacement of market with integral mode) is associated with reduction of costs for information supply (overcoming market

²⁰ All these difficulties make it impossible to use various models of Neoclassical Economics just by adding a new “transaction activity”.

uncertainty), permanent (re)negotiations along with constantly changing conditions of exchange, safeguarding investments from outside opportunism etc. On the other hand, it enlarges costs for organizational formation, decision-making, integral management, supervising and motivation of hired labor. In above example with the alternatives for marketing of output it could be preferred “internal marketing” (consumption, production utilization, processing) as more beneficial form of organization comparing to direct sell or employment of marketing cooperative.

Moreover, a part of transactions in agriculture is governed not by “pure” but through complex or interlinked modes - e.g. inputs supply in a “package” with know-how, extension or/and service supply; joint supply of inputs and credit; crediting of production against marketing of output. Thus, it is important to take into consideration the *overall* costs for organization of transactions of different types - all *external* and *internal* transaction costs of the farm.

Often it is very difficult to select a base for comparison in view that high transacting costs entirely block the development of an alternative organization. For instance, the market for agrarian credit has not emerged in Bulgaria during most of the transition period and the internal supply (utilization of own finance, direct outside co-investment) was the only possible form of finance supply of farms. Here the comparative level of transaction costs is impossible to be determined and the “high” efficiency of integral mode relative to debt form of financing is difficult to be appreciated. In that case the financing with “own funds” and with “bank credits” are not a real alternative, but completely different governing structures. Thus, the application of indicators for estimation of the comparative efficiency of investments based on “opportunity costs” (discounting, payback period, internal rate of return) independent from the form of funding, have no significant economic sense.

Comparative structural analysis

Another direction for evaluating efficiency of diverse agrarian organizations is the *Discrete structural analysis*.²¹ Since it is either very difficult or impossible to determine absolute transaction costs for individual modes, assessment is made on comparative costs of alternative organizations. Besides, quantitative approach (absolute and relative measures, marginalism) is replaced by qualitative (structural) analysis and indirect assessment of transacting costs.²² Actually, we are interested not in absolute level of transaction costs in different forms, but in organization with the lowest comparative costs for a particular activity/transaction.

The new approach for assessing economic organizations turns individual transaction and the costs associated with it into a *basic unit of economic analysis*. The analysis of agrarian organizations includes the following major steps: *First, the*

²¹ Williamson, O. The Mechanisms of Governance...

²² That is logical since individual governing structures differ from each other not in marginal but in a qualitative –discrete structural way.

major type transactions in which agent managing agrarian transactions (farm entrepreneurs, farmers) participates are to be determined. *Second*, the feasible *alternative forms for organization* of different types of agrarian transactions in the specific environment are to be identified. *Third, critical factors* of transaction costs, and costs (and benefits) associated with alternative governing modes are to be specified. *Forth*, the *comparative efficiency* of alternative modes is to be assessed, and the effective boundaries of market and private organizations defined. *Fifth*, cases of *market and private failures*, and the needs for public intervention are to be identified. *Six, the alternative (and feasible) forms for public intervention in agrarian sector* are to be identified, their *comparative efficiency* assessed, the best one(s) selected.

The major types of transactions in farming are associated with: labor supply, supply of land and natural resources, service supply, inputs supply, knowledge supply and know-how, innovation supply, finance supply, insurance supply, marketing of services and products. Farmers also take part in a great variety of “collective actions” for inducing public intervention in market and private sector in own interests. Identification of employed and other feasible forms for organizations of transactions in different countries, regions, subsectors is object of a special *micro-economic survey*.²³

Next, “critical dimensions” of transactions are to be determined – the factors responsible for the *variation* of transaction costs in the specific economic, institutional and natural environment. They are identified as: frequency of transactions between the same partners; uncertainty surrounding transactions; specificity of assets for supporting a particular transaction; appropriability of rights associated with transactions.²⁴

When *recurrence* of transactions between the same partners is high, both (all) sides are interested in sustaining and minimizing costs of their relations (avoiding opportunism, building reputation, setting up incentive and adjustment mechanisms, conflict resolution devices). Here continuation of the relations with a particular partner/s and designing a special mode for transacting has a high economic value. Parties restrain for opportunism which detection is “punished” by turning to a competitor (losing future business). Besides, costs for development of a special private mode for facilitating bilateral (or multilateral) exchange could be effectively recovered by frequent exchange. For instance, instead of negotiating milk marketing after “each milking” a long-term supply contract is signed; instead of negotiating labor remuneration “for each operation” a permanent labor is hired by

²³ E.g. the major forms for organizations in functional areas of Bulgarian farms are analyzed by *Bachev, H.* Management of Farm Contracts and Competitiveness...

²⁴ First three factors are identified by *Williamson, O.* The Mechanisms of Governance..., while the forth one added by *Bachev, H. and M. Labonne.* About Organization of Agrarian Innovations. Montpellier: INRA, 2000.

the cooperative; economies of scale and size for repeated transactions are realized though participation in inputs supply or marketing cooperative. When a transaction is occasional (incidental) then possibility for opportunism is great since cheating side can not be easily punished (good reputation is not of value).

When *uncertainty* surrounding transactions increases, then costs for carrying out and secure transactions go up (for overcoming information deficiency, safeguarding against risk). Since bounded rationality is crucial and opportunism can emerge agents will use such modes of organization which diminish transaction uncertainty. While certain risks could be diminished/eliminated by production management or through market mode (purchase of insurance) most transacting risk would require special private forms – trade with origins; providing guarantees; using share-rent or output-based compensation; employing economic hostages (e.g. obligatory collateral for providing a credit); participating in inputs-supply or marketing cooperative; complete integration of transactions. When transacting between same counterparts is rare, and it is not supported by specific assets, and private appropriability of rights is high, then faceless market exchange is most efficient mode. Depending on the level of uncertainty and the risk-aversion agents take different entrepreneurial risk and get normal, lower, or higher return from transactions.

Transaction costs get very high when *specific assets* for relations with particular partner are to be deployed. In this case it is impossible to change partner (alternative use of assets) without a big loss in value of specific capital.²⁵ Relation specific/dependent investments are “locked” in transactions with particular buyer or seller and cannot be recovered (rented) through “faceless” market transactions (counterpart's “personality” matters).²⁶ Costless alternative use of specific assets (loss of value) is not possible if transactions fail to occur, they are prematurely terminated, or less favorable terms are renegotiated (in contract renewal time before the end of life-span of specific capital). Therefore, dependant investment/assets have to be safeguarded by special form such as long-term or tied-up contract, interlinks, hostage taking, joint investment, quasi or complete integration. Often, later is quite expensive, investment in specific capital are not made, and activity/transactions can not take place (e.g. modern drop irrigation) or occurs without any (or loss of) comparative advantages in respect to productivity (no or manual irrigation).

If a high *symmetrical* (capacity, product, timing, location etc.) dependency of assets of counterparts exists (regime of “bilateral trade”) there are strong incentives in both parties to elaborate special private mode of governance. When *unilateral* (asymmetrical) dependency exists then dependent side (facing mini or total monopoly) has to protect investments against possible opportunism (behavioral

²⁵ E.g. investments in production of organic milk are quite specific for transactions with the single organic milk processor on the country.

²⁶ Specificity is not a technological but an economic characteristic feature of investments. Depending on the socio-economic conditions the same assets could be with quite a different level of specificity.

uncertainty/ certainty) through integrating transactions (unified organization, joint ownership, cooperative); or safeguarding them with interlinked contract, exchange of economic hostages, development of collective organization to outstand asymmetrical dependency (for price negotiation, lobbying for Government regulations).

Activity and transacting is particularly difficult when *appropriability of rights* on products, services or resources is low. "Natural" low appropriability has most of agrarian intellectual products - agro-market information, agro-meteorological forecasts, new varieties and technologies etc. Besides, all products and activities with significant positive/or negative externalities are to be included in this group. If appropriability is low, the possibility for unwanted market or private exchange is great, and the costs for protection (safeguard, detection of cheating, disputing) of private rights/investments - extremely high²⁷. Because of the bounded rationality, the costs for protection, detection, verification, and a third-party (court) punishment of unwanted exchange are extremely high. For transactions with low appropriability costs and benefits are independent of individual participants. Therefore, agents would either over-produce (negative externalities) or under-organize such activity (positive externalities) unless they are governed by efficient private or hybrid mode - cooperation, strategic alliances, long-term contract, trade secrets, or public order.

Effective forms for agrarian organizations

The next step is to evaluate the effective potential of alternative economic organizations: to minimize bounded rationality of agents and uncertainty surrounding transactions; appropriation and protection of absolute/contracted rights (and associated private benefits and investment) from possible opportunism; recover long-term costs for organizational development through high frequency of transactions; explore economy of size and scale on specific capital etc.

Individual organizations have different comparative advantages and disadvantages to maximize benefits and minimize costs of transactions with specific critical dimensions. In general, *internal* organization/integration has advantage for governing transaction with high uncertainty and specificity (dependency) of assets, since it diminishes bounded rationality and protects investments from outside opportunism. On the contrary, transactions with high certainty (bounded rationality is not important) and universal character of assets (opportunism can not be realized since a transaction can be executed with another partner without additional costs) can be carried across *free market* without encountering costs for development of special private mode. *Private organization* is effective only for transactions with high recurrence between partners, since occasional (single) transactions do not let

²⁷ E.g. the fight against hail clouds or grasshoppers invasion are with a low appropriability for supplier since paying or not all farmers in the region benefit from the service. Investments in development of a new technology are with low appropriability since it could be "introduced" with a single purchase or acquired for free by a neighbor, friend in the research institute, or on black market.

recovering (“payback”) investment for development of special governance mode (mechanisms for coordination, stimulation, dispute resolution; formal registration). Finally, *markets and private forms* are appropriate for transactions with high appropriability, since they would recover invested resources through exchange. For a transaction with low appropriability private rights cannot be protected (unwanted exchange) or they are enforced with extremely high costs. Thus, such transactions could be effectively governed either by *hybrid* (mixed public-private, quasi-public) or entirely *public forms* for organization.

Since transactions have different critical dimensions and governance forms have different comparative advantages it is to be “*alignment of transactions (which differ in attributes) with governance structures (which differ in costs and competence) in discriminating (mainly transaction cost economizing) way*”²⁸. According to the combination of specific characteristics of each activity/transaction, there will be *different the most effective form of economic organization for that particular activity* (Figure 1). Agrarian transactions with good appropriability, high certainty, and universal character of investments (partner can be changed anytime without significant costs) could be effectively carried across free market through *spotlight* or *classical contracts*. Here organization of transactions with special form or within farm/firm would only bring extra costs without producing any transacting benefits.

Figure 1

Principle modes for governing of agrarian transactions

Generic modes	Critical dimensions of transactions								
	Appropriability								
	High								Low
	Assets Specificity								
	Low				High				
	Uncertainty								
	Low		High		Low		High		
	Frequency								
	High	Low	High	Low	High	Low	High	Low	
Free market	Y	Y							
Special contract			Y			Y			
Internal organization					Y		Y		
Third-party involvement				⚡				⚡	
Public intervention									⚡

Y - the most effective mode; ⚡ - necessity for a third party involvement

Recurrent transactions with low assets specificity, and high uncertainty and

²⁸ Williamson, O. The Economics of Organization..., p. 548–577.

appropriability, could be effectively governed through a *special contract*. Relational contract is applied when detailed terms of transacting are not known at outset (high uncertainty), and framework (mutual expectations) rather than specification of obligations is practiced. Partners (self) restrict from opportunism and are motivated to settle emerging difficulties and continue relations (situation of frequent bilateral trade). Besides, no significant risk is involved since investments could be easily/costlessly redeployed to another use/users (no assets dependency exist). The special contract form is also efficient for rare transactions with low uncertainty, high specificity and appropriability. Dependent investment could be successfully safeguarded through contract provisions since it is easy to define and enforce relevant obligations of partners in all possible contingencies (no uncertainty). Here occasional character of transactions does not justify internalization within the farm/firm.

Transactions with high frequency, uncertainty, assets specificity/dependency, and appropriability, have to be organized within the farm/firm (*internal ownership mode*). For instance, managerial and technological knowledge (acquaintance with livestock, quality of farming plots) is quite specific to farm, and its supply has to be governed through permanent labor contract and coupled with ownership rights (products, assets). Capital investments in land are to be made on own/long-leased-in rather than seasonally rented land (high site and product specificity). All “critical” to farm tangible assets will be internally organized - production of forage for animals; important machinery; water supply for irrigated farming etc. While universal capital could be effectively financed by market form (bank credit), highly specific investments can be only made through internal funding (own funds, equity sell, joint venture).

If the specific and specialized capital cannot be effectively organized within the farm (economy of scale/scope explored, funding made), then an effective governing form(s) outside farm-gates is to be used - group farming, joint ownership, interlinks, cooperative, lobbying for public intervention. When strong assets (capacity, technology, time of delivery, site, branding) inter-dependency with upstream/downstream partner exists, then it is not difficult to govern transactions through contract mode (strong mutual interests for cooperation and restriction of opportunism). For instance, effective supply/procurement contracts between farmers and processors are widely used in dairy, meat, vine, organic industries (symmetrical dependency).

However, farmers very often face unilateral dependency and need effective (ownership) organization to protect interests. Transacting costs for initiating and maintaining such “collective organization” are usually high (big number of coalition, different interests of members, “free-riding”) and it is either unsustainable or does not evolve at all. That creates serious problems for efficiency/sustainability of individual farms - missing markets, monopoly/quasi-monopoly situation, impossibility to “induce” public intervention.

Serious transacting problems arise when condition of assets specificity is combined with high uncertainty, low frequency, and good appropriability. Here elaboration of special governing structure for private transacting is not justified, specific investments are not made, and activity/restriction of activity fails to occur at effective scale ("market *and* contract failure"). Similar difficulties are encountered for rare transacting associated with high uncertainty and appropriability. In all these cases, a *third-party* (private, NGO, public) *involvement* in transactions is necessary (assistance, arbitration, regulation) in order to make them more efficient or possible. A particular trilateral mode is also invented such as the *neoclassical contract* which arranges "third party participation" and manages transactions with high uncertainty and asset specificity, and low frequency. The unprecedented development of special origins, organic farming, systems of "fair-trade" are good examples. The consumer's demand (premium) for organic, original, and fair-trade products is increasing. Nevertheless their supply could not be met without any effective trilateral governance including independent certification and control.

When appropriability associated with transaction/activity is low, there is no pure market mode to protect and carry out activity effectively. Respecting others rights (unwanted exchange avoided) or "granting" additional rights to others could be governed by "*good will*" or *charity actions* of individual and NGOs. For instance, a great number of voluntary environmental initiatives have emerged driven by the competition, farmers' preferences for eco-production, or responds to public pressure for a sound eco-management. In any case, voluntary initiatives could hardly satisfy the entire social demand especially if they require significant costs.

Some private modes could be employed if high frequency and mutual assets dependency exists such as unwritten accords, interlinking, bilateral or collective agreements, close-membership cooperatives, codes of professional behavior, alliances, internal organization. However, emerging of special (private) large-members organizations for dealing with low appropriability (and satisfying entire "social" demand) would be very slow and expensive, and they are unlikely to be sustainable in long run (free riding). Therefore, there is a strong need for *third-party public intervention* in order to make such activity possible or more effective – public organization, public contract, mandatory taxing, introduction of new property rights. For example, the supply of "environmental goods" by farmers could hardly be governed through private contracts with individual consumers because of low appropriability, high uncertainty, and rare character of transacting (high costs for negotiating, contracting, charging potential consumers, disputing). The supply of environmental protection service is very expensive (production and organization costs) and would unlikely be carried out on voluntary basis. Financial compensation of farmers by willing consumers through pure market mode (tax, premium) is also ineffective due to high information asymmetry and massive enforcement costs. A third-party mode with direct public involvement would make

that transaction effective: on behalf of consumers a State Agency negotiates with individual farmers a public contract for “environment conservation service”, coordinates activities of various agents (including direct production management), provides public payments for compensation of farmers, and controls implementation of negotiated terms.²⁹

Economic boundaries of the farm

The next step is to identify the range of feasible organizational forms for each generic mode for the specific context of a particular country, region, subsectors, and agent. For instance, the specific varieties of the “internal organization” in agriculture include: *one-person farm or firm, family farm or firm, group farm or firm (partnership), cooperative, corporation, public farm or firm, joint venture*. Corresponding forms of the “free market” are: *spot exchange on local, regional etc. markets; classical contract, wholesale trade etc.* The “special contract form” could be: *short-term contract, long-term contract, relational contract, interlinked organization, multilateral agreement etc.* For completing the list of alternative organisational forms in each generic type a special *micro-economic survey* is needed.

Then the *effective (horizontal and vertical) boundaries* of individual forms could be determined on the basis of their potential to: overcome bounded rationality and transaction uncertainty, safeguard transactions and investments from the hazard of opportunism, realized economies of scale/size of specialized and specific capital, and minimized overall (production *and* transaction) costs. Achieving the efficiency though increasing productivity/benefits and the transaction costs for each form will be quite different in the specific institutional, economic and natural environment for agents with diverse characteristics and activity/transactions with specific combination of critical dimensions. Therefore, individual organizations will have quite *different efficiency and effective boundaries*. A part of agrarian transactions will be effectively governed through free market exchange; another part will be effectively organized through special contract mode(s); a part of transactions will be entirely integrated within farms of different types, while the rest protected though special private organization(s) outside of farm gates.

Detailed analysis of factors, pace of development, efficiency and economics boundaries of farms and agrarian organizations of different type during transition and EU integration in Bulgaria is done by us in previous publications³⁰ For instance, the high efficiency and sustainability of numerous small (subsistent, semi market and market) farms is “explained” with the absence of another feasible or more-effective alternative for production utilization of available household resources (labor, savings, farmland)³¹ under the condition of not-fully restituted private rights

²⁹ Namely *public eco-contracts* with farmers are widely used in the EU countries.

³⁰ Bachev, H. Management of Farm Contracts and Competitiveness...

³¹ Post 1989 privatization turned more than 2 million Bulgarians into owners of small farmland plots and

on resources; high uncertainty, risk and costs for market and contract transactions (lack of experience, trust, markets, financing; not-functioning system for enforcement of laws and contracts); lack of public support; insufficient or missing possibilities for alternative employment and/or supply with (cheap, quality) foods.³²

Similarly, “dynamic” development of agricultural cooperatives with many-members during post-communist transition is a consequence of the fact that they are the single/most effective form for organization of a numerous activities (joint cultivation, plot protection, irrigation, harvesting; non-for-profit organization for supply of highly specific for members employment, foods, services, feeds for domestic/private farm livestock) in the conditions of unidentified rights on major agrarian resources, lack of possibilities (skills, financial assets, time, advanced age) for organization of own farm, inherited high inter-dependency of available specialized capital of a large number individuals³³, and undeveloped labor market, agrarian resources and main activities (services, processing, trade) in rural areas.

In the same way, the unprecedented concentration of resources and activities in several thousands of large business agri-firms is a result of the dynamic institutional environment favorable for integration of large specific capital by entrepreneur (technological and managerial knowledge, personal connections, available combination of and/or complementarities of partners assets) allowing exploration of enormous (land consolidation, economies of size and scale, cheap and standardized products) and transaction advantages (contract and political power, preferable counterpart by large suppliers and buyers, possibilities to collect information, introduction of innovations, diversification, products promotion, adaptation to market and formal requirements, winning public projects and subsidies, risk taking, investing in good reputation and relations with partners, banks, research institutes, and public authorities).

At this stage a qualitative analysis is made on the comparative efficiency of diverse type of farms and agrarian organizations in the specific socio-economic, institutional and natural environment. It is often impossible to co-measure production and transaction costs in a qualitative term, but such “calculation” is always made by the business managers and other economic agents. Also an answer is given to the “paradox” *why a big farm can not do the same and more than a number of small farms can do, and vice versa*. Furthermore, the inadequacy of indicators for productivity of production costs and resources for assessing efficiency of the *different* agrarian organizations becomes evident. The opposite is to be expected: it has to be significant variation in the rate of profitability on investments

shares in the property (animals, equipment, indivisible assets) of former public farms.

³² Even now most of the holdings in the country are subsistent or semi-market, and agriculture is a “supplementary income source” for more than 1 million Bulgarians (Agrarian Paper, MAF, 2008).

³³ Restituted widely dispersed small-scale land plots, farmland within a large plot with permanent crops, physically “indivisible” shares in assets of former farms, accumulated experience and narrow labor specialization for “collective” production.

in an agro-firm (profit-making organization) from “pay-back” of expenditures and resources in a cooperative (member-oriented organization), a public farm (non-for-profit organization) or a subsistence farm (giving opportunity for productive use of otherwise “non-tradable” family labor, land). The later is also proven by the estimates on “efficiency” of different farms in Eastern Europe after 1989.³⁴

Traditional statistical and other data are less suitable for testing and wide application of the new approach. It is necessary to collect *micro-economic data* for diverse transactions managed by various agrarian agents and their critical dimensions. Such information can be collected though organizing interviews with managers of different type farms and the experts in the area.

Needs and effective forms for public intervention

The Comparative structural analysis enables us to specify existing and emerging deficiencies in the organization of market and private transactions, and define the *needs for public intervention in agrarian sector* (“the economic role of government”). In modern agriculture there are always some public modes put in place along with diverse market and private organizations, and ideally it could be a case of most effective/perfect economic governance of the sector. However, usually there are a number of social, economic, environmental etc. challenges (problems, conflicts, failures, risks) associated with agrarian development. That is why, there is a constant need for improvement of public organization.

First, assessment on correspondence of public involvement in real needs of development – these are identified needs for a third-party intervention from Figure 1. The analysis is to embrace the efficiency of the entire system of governance, and identify deficiencies (failures, risks) in market, private, *and* public organizations. Next, variety of alternative modes for *new* public intervention able to correct market, private and public failures have to be identified, and their comparative efficiency assessed, and most efficient one(s) selected. Finally, assessment is to be made on comparative efficiency of selected public form to other practically possible modes of governance such as partnership with the private sector, fundamental property rights modernization, international cooperation etc. Accordingly, a new public intervention is to be initiated only if there is an *overall net benefit* - when *effects are greater than additional (individual and social) costs for third-party public involvement*.

The comparative efficiency of public interventions is to be determined in terms of the potential for coordination, stimulation, conflicts resolution, and minimization of (transaction) costs. Public modes not only assist (market and private) transactions, but are also associated with significant (social and private) costs. It is essential to compare practically (technically, economically, socially)

³⁴ Csáki C. and Z. Lerman. Structural change in the farming sectors in CEE. Washington DC, 2000; Gortova, M. and S. Davidova. Op. Cit.; Mathijs, E. and J. Swinnen. Production Organization and Efficiency during Transition. Policy Research Group, 1997.

possible and alternative forms of governance. Additional *benefits* (problems to be solved, risks to be overcome, new goals to be achieved), and *costs*, and *modes* for new public intervention must be *socially acceptable*. If different forms permit achieving the same goals, then the analysis is to focus on selection of mode minimizing total (implementing and transacting) costs. If there is only one feasible form for governing a particular intervention, it will be introduced if associated costs are *socially acceptable and possible*.

Assessment is to comprise *all* costs – direct (tax payer, assistance agency) expenses, and transacting costs of bureaucracy (for coordination, stimulation, mismanagement), and costs for individuals' participation and usage of public modes (expenses for information, paper works, payments of fees, bribes), and costs for community control over and for reorganization of bureaucracy (modernization and liquidation), and (opportunity) costs of public inaction.

Depending on uncertainty, frequency, and necessity for specific investment of public involvement, the most effective forms will be different (Figure 2). Generally, interventions with low uncertainty and assets specificity would require a *smaller public organization* (more regulatory modes; improvement of general laws and contract enforcement). When uncertainty and assets specificity of transactions increases a *special contract* mode would be necessary – employment of public contracts for provision of private services, public funding/subsidies of private activities, temporary labor contract for carrying out special public programs, leasing-out public assets for private management etc. When transactions are characterized with high assets specificity, uncertainty and frequency then internal mode and *larger public organization* would be necessary – permanent public employment contracts, in-house integration of crucial assets in a specialized state agency or public company etc.

Figure 2

Effective modes for public intervention in agrarian sector				
Level of Uncertainty, Frequency, and Assets specificity				
Low		High		
New property rights and enforcements	New regulations	New taxation	New assistance and support	New public provision

Initially, existing and emerging problems (difficulties, costs, risks, failures) in organization of market and private transactions have to be specified. The appropriate public involvement would be to *create environment* for: decreasing uncertainty surrounding market and private transactions, increasing intensity of exchange, protecting private rights and investments, and making private investments less dependent. For instance, if the State establishes and enforces quality, safety and eco-standards, certifies producers, regulates employment

relations, transfers management rights on natural resources etc., all that would facilitate and intensify (market and private) transactions and would increase the efficiency of economic organizations.

Next, practically possible modes for increasing appropriability of transactions have to be considered.³⁵ The low appropriability is often caused by unspecified or badly specified private rights. In some cases, the most effective government intervention would be to introduce and enforce *new private property rights* – on natural and biological resources; tradable quotas for products, inputs, emissions; intellectual property and origins. That is efficient when privatization of resources or introduction and enforcement of the new rights is not associated with significant costs (uncertainty, recurrence, and level of specific investment are low). That intervention transfers organization of transactions into market and private governance, liberalizes market competition and induces private incentives (and investments) in certain agrarian activities.

In other cases, it is more efficient to put in place *regulations* for trade and utilization of resources, products and services – standards for labor (safety, social security), product quality, environmental performance, animal welfare; norms for using natural resources, introduction of foreign species and GM crops, and (water, soil, air, comfort) contamination; ban on application of certain chemicals or technologies; regulations for trading ecosystem service protection; foreign trade regimes; mandatory eco-training and licensing of farm operators.

In other cases, using incentives and restrictions of *tax system* is the most effective form for intervention. Different sorts of tax preferences are widely used to create favourable conditions for development of certain (sub)sectors and regions, forms of organization, segment of population, or types of activities. For instance, environmental taxation on emissions or products (inputs, outputs of production) is applied to reduce the use or emissions of harmful substances.

In some cases, *public support* to private organizations is the best mode of intervention. Agrarian and rural development, environmental conservation and trans-border cooperation programs are widely used in all countries. Often providing *public information, recommendations, and training* to farmers, rural population, and consumers is the most efficient form. In some cases, *pure public organization* (in-house production, public provision) is the most effective method as in case of important agro-ecosystems and national parks; agrarian research, education and extension; agro-meteorological forecasts; border sanitary and veterinary control etc.

Usually, specific modes are effective if they are applied only with other modes of public intervention. The necessity of *combined intervention* (governance mix) is caused by: complementarities (joint effect) of individual forms; restricted

³⁵ E.g. assessment of the efficiency of major forms of public intervention in agro-ecosystem services are presented by Bachev, H. Governing of Agro-ecosystem Services. Modes, Efficiency, Perspectives...

potential of some less expensive forms to achieve certain (but not entire) level of socially preferred outcome; possibility to get extra benefits (e.g. “cross-compliance” requirement for participation in public programs); particularity of problems to be tackled; specific critical dimensions of governed activity; uncertainty (little knowledge, experience) associated with likely impact of new forms; administrative and financial capability of Government to fund, control, and implement different modes; and dominating policy doctrine.

The level of effective public intervention (governance) also depends on the *kind of problem* and the *scale of intervention*. There are public involvements which are to be executed at *local* (ecosystem, community, regional) level, while others require *nationwide* governance. And finally, there are activities, which are to be initiated and coordinated at international (regional, European, worldwide) level due to strong necessity for *trans-border actions* (needs for cooperation in natural resources management, exploration of economies of scale and scale, governing of spill-overs) or consistent (national, local) government failures. Very frequently effective governance of many problems and risks requires *multilevel governance* with system of combined actions at various levels involving diverse range of actors and geographical scales.

The public (regulatory, provision, inspecting) modes should have established mechanisms for *increasing competency* (decreasing bounded rationality, powerlessness) of bureaucrats, beneficiaries, interests groups and public as well as *restricting possible opportunism* (cheating, interlinking, abuse of power) of public officers and stakeholders. That could be made by training, introducing new assessment and communication technologies, increasing transparency (independent assessment and audit), and involving experts, beneficiaries, and interests groups in management of public modes at all levels. Furthermore, applying “*market-like*” mechanisms (competition, public auctions) in projects design, selection and implementation could also increase incentives and decrease overall costs.

The *pure* public organization should be used as a “*last resort*” when all other modes do not work effectively. “In-house” public organization has higher (direct/indirect) costs for setting up, running, controlling, reorganization, and liquidation. Unlike market and private forms there is no automatic mechanism (competition) for sorting out less-effective modes.³⁶ Here public “decision-making” is required which is associated with high costs and time, and it is influenced by strong private interests (lobbying groups, policy makers and associates, bureaucrats) rather than efficiency. What is more, widespread “inefficiency by design” of public modes is practiced to secure (rent-taking) positions of certain interest groups, stakeholders, bureaucrats. Along with development of general

³⁶ Many inefficient, but “sustainable” public organizations could be observed in Bulgaria and all over the world.

institutional environment ("The Rule of Law", transparency) and measurement, communication etc. technologies, the efficiency of pro-market modes (regulation, information, recommendation) and contract forms would get bigger advantages over internal less flexible public arrangements.

The *hybrid modes* (public-private partnership) are much more efficient than pure public forms given coordination, incentives, and control advantages. Involvement of farmers, beneficiaries and interest groups increases efficiency, decreases asymmetry of information, restricts opportunisms, increases incentives for private costs-sharing, reduces management costs. That is determined by farmers information superiority, strong interlinks of activity with traditional food production (economy of scope), high assets specificity to farms (farmers competence, high site-specificity of investments to farm, land, eco-system), spatial interdependency (needs for cooperation of farmers at ecosystem or regional level), farm's origin of negative externalities. For instance, enforcement of most labor, animal welfare, environmental standards is often very difficult or impossible. Stimulating and supporting (assisting, training, funding) private voluntary actions are much more effective than mandatory public modes in terms of incentive, coordination, enforcement, and disputing costs.

If there is a strong need for third-party public involvement but effective (government, local authority, international assistance) intervention is not introduced in time, agrarian "development" is substantially deformed. The *public (Government) failure* is also possible and often prevails. In Bulgaria, there were a lot of bad examples for public under- and over-interventions in agrarian sector during the post-communist transition period. Consequently, primitive and uncompetitive small-scale farming; predominance of over-integrated and personalized exchanges; ineffective and corrupted agrarian bureaucracy; blocking out all class of agrarian transactions (innovation and extension supply, long-term credit supply, supply of infrastructure and environmental goods); and developed large informal sector, all they come out.

The comparative analysis enables us to *improve design* of new forms of public intervention according to specific market, institutional and natural environment of a particular country, region, sub-sector, and in terms of perfection of coordination, adaptation, information, stimulation, restriction of opportunism, controlling of participating actors (decision-makers, implementers, beneficiaries, other stakeholders). It enable us to predict likely cases of *new* public (local, national, international) failures due to impossibility to mobilize sufficient political support and necessary resources and/or ineffective implementation of otherwise "good" policies in specific economic and institutional environment of a particular country, region, sub-sector. Since *public* failure is a feasible option, its timely detection permits foreseeing the persistence or rising of certain problems in agrarian development, and informing (local, international) community about associated risks.

*

In the unreal economy “without institutions and transaction costs” the theory of agrarian organization is very simple - there is no economic need for organizations. There is a single mechanism for governing, organizing, coordinating, and stimulating the overall economic activities – the free market. “A situation of efficiency” is easily achieved since agrarian agents (individuals, households, firms) automatically and costlessly adapt their behavior according to the movements of the market prices and the changes in production technologies. In the real agrarian economy with diverse agents, institutions and transaction costs there is a place for other effective (non-market) modes for organization – farms of different types and sizes, contracts, public and hybrid forms. “The old” problem of efficiency finds a “new” dimension through incorporation into analysis of the costs of transacting as the focus is on the assessment of the comparative efficiency of all (rather than only a part) of the alternative modes of economic organization. The traditional “black box” approach in analysis of governing structures and the productivity as a sole indicator for efficiency of different type of farms have become absurd.

The suggested new framework helps us better understand the factors for organizational choice and efficiency, and needs for public intervention in the agrarian sector. The analysis of transaction costs identifies immense range of “market failures” associated with badly specified property rights and inefficient system for their enforcement; the high uncertainty and dependency on activity, low appropriability etc. Private agents “deal” with market deficiency developing different non-market forms for effective governance such as contracts, internal modes, trilateral private organization, collective actions. Private sector also “fails” to safeguard individual rights and carry out certain activities at effective scale (technological development, eco-management). There is a strong need for a third-party public involvement in market and private transactions through institutional modernization, assistance, regulation, hybrid or in-house public organization. Diverse forms of public interventions have unequal efficiency in the specific environment of individual countries, regions, and sectors, and the most efficient ones are to be selected taking into account the transaction costs and contribution to sustainable development. A “public failure” is also possible, and inappropriate involvements, under or over-regulations, mismanagement, corruption are widespread. Agrarian sustainability is compromised when market and private sector fail, and no effective public intervention takes place - imperfect institutional structure is not reformed, delayed or bad government interventions prevail, fruitless international assistance dominate, and the needed global governance is not established.

7.II.2012

Copyright of Economic Thought is the property of BAS Institute of Economics and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.