

# Could social capital help Czech agriculture?

## *Může sociální kapitál pomoci českému zemědělství?*

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**Abstract:** Recent literature and research on social capital has demonstrated the economic importance of social features, such as trust and norms that facilitate cooperation. This article focuses on the role of social capital in the context of the Czech agricultural sector. Obtaining credit, sharing machinery, and proliferating information serves as examples where an awareness and reliance on the social capital of rural communities matter. By forming groups and strengthening existing networks, Czech farmers can improve their productivity, as well as their welfare. The article concludes by warning that the Czech state cannot invest directly in social capital, but should create the necessary legal and economic incentives to encourage the formation of social capital.

**Keywords:** social capital, cooperation, transition, agriculture

**Abstrakt:** Současná literatura a výzkum v oblasti sociálního kapitálu poukazují na to, že určité sociální aspekty venkova, jako jsou důvěra a různé normy, napomáhají spolupráci. Tento článek se zaměřuje na úlohu sociálního kapitálu ve vztahu k českému zemědělskému sektoru. Získávání úvěru, sdílení mechanizačních prostředků a rozšiřování informací jsou jen příklady toho, kde povědomí a důvěra v sociální kapitál venkovských společenství hraje důležitou úlohu. Seskupováním a zesilováním současné sítě kontaktů čeští zemědělci mohou zlepšit svoji produktivitu i vlastní prosperitu. Tento článek je uzavřen varováním, že český stát nemůže přímo investovat do sociálního kapitálu, může však vytvářet potřebné právní a ekonomické prostředí, které iniciuje formaci sociálního kapitálu.

**Klíčová slova:** sociální kapitál, spolupráce, transformace, zemědělství

## INTRODUCTION

Recent literature on social capital posits that totalitarian regimes like the former Central European Communist systems destroy social capital. Even after a decade of transition, the social capital of post-communist countries is therefore weak, and these low levels may explain why their national incomes are low relative to the levels of physical and human capital (Paldam, Svendsen 2001). In particular, these countries seem to have large parts of the populations tending to rely passively on the state (Putnam 1995), a feature also to be found in the Czech society as a whole, and its agricultural sector in particular.

Unfortunately, countries with low stocks of social capital seem more likely to have bad policy outcomes, low investment rates and problems with corruption – factors that impede growth and development. After the sharp contractions of GDP following the overthrow of the Central European communist regimes, these countries have a specific need to recover and grow to re-establish their positions as equals to Western European countries in both social and economic terms.

The Czech Republic is one of the few post-communist countries that have surpassed their official pre-transition GDP, and a front-runner for the EU accession. However, a substantial effort still needs to be made in order to restructure certain sectors in the Czech economy. Agriculture in particular has structural problems to be solved before being able to reap the significant gains from full access to the EU markets (Chloupková 2002). As in all transition countries, Czech farmers have to regain initiative and re-learn how to cooperate.

The aim of this article is therefore to illustrate how an awareness and use of social capital can help solve certain problems in the Czech agricultural sector. The article is concluded with suggestions for the Czech agricultural sector based on international experiences.

## SOCIAL CAPITAL

Sociologists have known for almost a century that norms and networks matter for economic and social performance, and as economists have begun to take an in-

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terest in the topics, real quantification has been made possible. Although the social sciences still lack a consensus on what precisely to measure, several studies have found significant links between social indicators and economic growth. These indicators, captured under the heading 'social capital', seem to enable economic growth per se (Knack, Keefer 1997; Temple 1998; Zak, Knack 2001) while simultaneously making economies less vulnerable to shocks (Rodrik 1998; Woolcock 1999).

The most popular definition of social capital derives from Robert Putnam's (1993) seminal work on regional administration in Italy. The definition is "features of social organizations, such as trust, norms and networks, that can improve the efficiency of society by facilitating coordinated actions" (Putnam 1993, p. 167). To enable an identification of the real causes and effects of certain problems, social capital can be decomposed into two elements: (i) a bonding element – social capital associated with knowing and trusting your family, close friends and professional colleagues, and (ii) a bridging element – social capital associated with knowing people outside your immediate social network (e.g. as in Woolcock 1999; Grootaert 1998).

In a personal way, it is a nice thing to know people. The question is, however, how social capital works in an economic sense? In other words, what are the mechanisms that link social capital and economic performance? The literature contains almost as many examples and views on the mechanisms behind social capital as there are researchers dealing with the topic. Here, a few examples from agricultural sectors will suffice.

Social capital helps low-income farmers access credit, although not in all countries. The 19<sup>th</sup> century German credit cooperatives – the Raiffeisen banks that subsequently spread from Germany to the rest of Europe – relied on joint liability, which worked well as the borrowers operated within the same social network and hence had the ability to both monitor each other and punish 'amoral' behaviour such as not repaying a loan. Such self-reinforcing behaviour amounted to an asset for the farmers, i.e. their social capital (van Bastelaer 1999). This mechanism is used in the present day micro-finance programmes such as the Bangladeshi Grameen Bank and the Bolivian BancoSol and has been known to work in revolving funds and rotating savings and credit associations throughout the world for centuries. It serves as one of the most prominent explanations of their success, as it makes borrowers screen other potential borrowers, thereby providing the bank with valuable information at very low transaction costs.

In a broader perspective, such information gathering and sharing can also entail significant gains for individuals and communities, as well as for entire societies. These gains arise for example from better factor utilisation (Weijland 1999; Grosh, Somolekae 1996), enabling

firms to share orders and marketing in an otherwise competitive business environment (Bazan, Schmitz 1997), accessing foreign companies and markets (Bebbington 1997), and improving the management of common pool resources (Anderson et al. 2000). The endowment and structure of individuals' and communities' social capital has therefore substantial impacts on the livelihoods of all people. Not least in the transition countries, special needs such as updating know-how (e.g. reading market signals, acting in a market), better information sharing (spreading know-how), access to credit and capital, as well as access to foreign markets can be met by being aware and relying on the existing social capital of e.g. the Czech society.

## INTERNATIONAL EXPERIENCES

In many countries, some form of cooperative banks serves the agricultural financial market. Although the Czech Republic has positive historical experiences with such banks – known as *kampelička* in Czech – post-transition attempts at reviving their existence failed in the 1990s due to bad legal provisions and a subsequent loss of public credibility (Kubačák 1992; Pithart 2000). As a consequence, the demand for financial services to small and medium sized actors in the Czech agricultural sector currently exceeds the supply. This situation poses a problem for the continued transition and modernising of Czech agriculture.

If banks are willing to run the risk and politicians are capable of providing proper legal provisions, solutions that imply relying on existing social structures and social capital in rural societies may be applicable to these problems. Specifically, lessons learned from micro-financial arrangements in developing countries can probably be tailored to Central European needs. As proposed in Chloupková, Bjørnskov (2002), enabling small groups of farmers to access both savings and credit facilities as a single legal entity might ease the substantial credit constraints that are presently preventing many investments in agriculture.

Such an arrangement relies in particular on the norms embedded in and strength of local social networks, i.e. on the social capital of the rural community and the specific farmers having an investment need. If these farmers trust each other in financial transactions, this trust can allow them to access credit for potentially profitable investments, given that the necessary legal provisions are in place and banks are willing to supply such services. Furthermore, experiences from Latin American middle-income countries show that serving this market can indeed be very profitable for banks as they minimise the otherwise high transaction costs associated with serving a low-income market with small transaction sizes.<sup>2</sup>

<sup>2</sup> The experiences of BancoSol in Bolivia and Banco Caja Social in Colombia suggest that serving microfinancial markets can be very profitable, even in the short-run (Paxton 1999; Fidler 1998).

Evidence from other Central European countries suggest that the level of social capital in the Czech Republic is probably significantly higher than in most Latin American countries.<sup>3</sup> Introducing such solutions in an attempt to ease credit constraints for small and medium sized Czech farmers will therefore be comparably easier and cheaper than in Latin America, *ceteris paribus*.

Furthermore, being explicit about relying on certain social institutions may help banks solve screening problems in other rural settings. The social capital of individuals may therefore ease their access to credit, as found to be the case in other countries (van Bastelaer 1999). Providing banks with better information on individual borrowers can thus also lead to softer credit constraints as a result of individuals' social capital.

Having trust in other members of the social network can also lead to sharing of other assets than information. Sharing orders and marketing can have beneficial effects for otherwise competing companies by e.g. sharing individually prohibitive costs (Bazan, Schmitz 1997; Schmitz 1999). As the Indonesian example in Weijland (1999) illustrates, sharing machinery can lead to substantial economies of scale.

Another mechanism through which social capital influences economic performance is by enabling co-operation without explicit contracting. In a situation without trust between any partners of an agreement, a complete, all-inclusive contract will have to be written to capture all possible contingencies and what duties accrue to which partners in each contingency. Such contracts are burdensome and expensive to negotiate and write. However, when partners trust each other to a certain degree, some contingencies can be left out of the contract, making it cheaper. In situations where the partners belong to the same social network (or overlapping networks), the partners often trust each other sufficiently not to write a contract at all. As the partners to a large degree share the norms embedded in these networks, they can rely on the social network to punish any defections from the norms instead of having to rely on a costly written contract stipulating what happens in any contingency. In other words, they have an implicit contract that amounts to a stock of social capital supplying a flow of cost-reducing services.

Such implicit contracts based on the social capital in the communities are often seen in agriculture. For example, the Danish machinery stations that enable a different form of machinery sharing than the joint purchase described above rely on such contracts.<sup>4</sup> Farmers can outsource certain on-farm jobs such as sowing and harvesting by calling upon the services of these machinery

stations. A price is agreed upon before the work is done, and the deal is in most cases settled with a handshake. Although a plethora of things can go wrong for both parties as in all agricultural enterprises, written contracts are very rare in this market. This is more surprising as the competition is often hard, thereby driving prices down and creating real incentives to defect from the implicit contracts. However, the social capital of Danish farmers seems to be sufficiently strong to prevent all but a very limited number of disputes. This social capital, consisting of dense social networks (i.e. where everybody knows everybody), strong norms regarding what services should cost and what to do in most contingencies, and high interpersonal trust, thereby saves many contract-related costs for Danish farmers.

Naturally, such social capital works through mechanisms that distribute information on the trustworthiness of individuals – i.e. their reputation – across the social networks. Other information, whether it is professionally relevant information, word-of-mouth or sheer gossip, can flow through the same channels. These channels predominantly consist of oral communication, i.e. conversations on the phone and face-to-face, and both first and second-hand sources. Particularly relevant to agriculture, the intangible knowledge of hands-on experience can probably only be shared in face-to-face communication. Such communication is practiced in social networks, and more so the more trusting and stronger these networks are. In other words, the social capital consisting of being a trusted member of social networks can therefore contribute to individuals' knowledge, i.e. their human capital, which in turn contributes to their productivity and income.

The examples above are only a few of the many mentioned in the literature. They are, however, chosen, as they are particularly relevant to the current situation in the Central European agricultural sectors. It will be discussed in the following section how the social capital of rural communities in the Czech Republic might be a potential enabling source of growth and adjustment of the agricultural sector.

## SUGGESTIONS

Communist-style, reformed collective farms and cooperatives predominantly rely on third-party enforcement. Yet, third-party arrangements demand a substantial control apparatus to monitor the behaviour of workers; otherwise, unwanted behaviour such as free riding (e.g. 'laziness') cannot be avoided as workers do not have ra-

<sup>3</sup> As part of an ongoing effort to measure and quantify the impact of social capital in Europe, estimates on Slovenian social capital were presented by Martin Paldam at the workshop on public choice in Copenhagen, November 30<sup>th</sup>, 2001. Although significantly smaller than Danish levels of social capital, the Slovenian estimates and circumstantial evidence from rest of Central Europe seem to suggest that the levels of social capital in these countries are significantly higher than in, for example Bolivia (Grootaert, Narayan 2000) and Colombia (Sudarsky 1999).

<sup>4</sup> We are indebted to Thule Knudsen Berg for providing us with much precise information on the Danish machinery stations.

tional incentives to perform cooperatively. Such control is nevertheless costly and was therefore largely ignored in the fundamental design of communist cooperatives, which had to rely on self-monitoring mechanisms among the workers.

A fact often mentioned in the social capital literature is that communist and other totalitarian systems destroy social capital. They therefore also destroy the self-monitoring mechanisms and the norms governing the work efforts. On this background, the low productivity and poor performance of most cooperatives is hardly surprising.<sup>5</sup> As data illustrates, most cooperatives are performing poorly and should be left to their own demise (Chloupková 2002), while the cooperatives that have sufficient stocks of social capital will probably tend to function significantly better than most other agricultural enterprises and should be allowed to continue unchanged.

As a consequence, the available government resources should be used on the private agricultural sector. Based on the three potential mechanisms outlined above, three suggestions for employing these mechanisms in the private Czech agricultural sector arise: (i) a focus on self-monitoring and the punishment of 'amoral' behaviour imposed by peers in a given social network is at the core of most explanations of how social capital works. This mechanism is for example often identified as the driving force behind the success of micro-financial programs in low- and middle-income developing countries. As argued by Chloupková and Bjørnskov (2002), given that provisions for recognising groups with joint liability as legal entities exist, banks may profit from entering a low-income agricultural market segment while farmers can prosper as credit constraints are eased, thereby enabling investments in machinery and restructuring. In other words, if farmers trust their neighbours sufficiently, banks could potentially benefit from letting them monitor and screen each other when receiving group loans; (ii) if farmers have incentives to cooperate on such things as borrowing money for investments, they will be induced to meeting more frequently to monitor each other and discuss loan-related issues. Getting together for specific purposes will normally lead to conversations on other subjects, and thereby exchanges of information, knowledge and experiences. These exchanges can add to their social capital by increasing the human capital of the individual farmers and can thus lead to productivity increases and the adoption of new technology (Isham 2000), two improvements heavily needed by Czech agriculture; (iii) last, but not least, increasing the information on and trust in other members of social networks can ultimately lead

to cost-reductions related to contracting in the sector. As the example of Danish machinery stations illustrates, free information flows and sufficient trust in other members of social networks and rural communities can enable farmers to avoid writing expensive, inclusive contracts. The derived cost-reductions can help the creation of small agricultural service enterprises, a feature found in most developed countries, by lowering the start-up and operations costs below a prohibitive threshold.<sup>6</sup>

The examples above illustrate the importance of tapping into the social capital of rural communities. An obvious question is therefore how to strengthen the social capital Czech farmers and rural societies. In other words, can the Czech Republic *invest* in social capital? Probably not. The Czech state can, however, invest in creating a legal and economic environment conducive to building social capital from the bottom. Such efforts amount, for example, to creating a proper legal framework in which small groups are accepted as legal entities, thus enabling them to cooperate on borrowing money, and thereby easing the credit constraints they face. Providing proper legal and economic incentives to cooperate at an individual level can therefore encourage the accumulation of social capital.

In general, the government should assure that the barriers to informal cooperation and the formation of voluntary organisations are minimised. Such voluntary organisations, whether they form networks specific to agriculture or more are inclusive, all generate social capital in the community, and should therefore be allowed to evolve uninterfered.<sup>7</sup> In all other respects, the state should not interfere directly in the free formation of trust, norms and networks. Interfering at all levels of society was the approach taken by all communist systems. Czech politicians and decision makers should not repeat the past mistakes.

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<sup>5</sup> State farms, which are on average significantly larger than the cooperatives, have been experiencing the same problems although on a comparatively larger scale (Chloupková 2002; Doucha 2001).

<sup>6</sup> High start-up costs were identified as an important barrier to the entrance of young farmers in the European agricultural sectors (Parish 2000).

<sup>7</sup> More inclusive organisations, specifically those with a non-economic aim, seem to generate the most social capital. In a quantitative study, Stolle and Rochon (1998) found that cultural organisations were most efficient in generating social capital.

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