

**Mariusz Maciejczak, Paweł Grzelak**

*Warsaw University of Life Sciences – SGGW, Poland*

**FROM COMMON POLICY TO COMMON INSTITUTIONS.  
INSTITUTIONAL ARRANGEMENT IN THE INTERNATIONAL SYSTEM  
ON THE EXAMPLE OF THE COMMON AGRICULTURAL POLICY**

*OD WSPÓLNEJ POLITYKI DO WSPÓLNYCH INSTYTUCJI. PORZĄDEK  
INSTYTUCJONALNY W SYSTEMIE MIĘDZYNARODOWYM NA PRZYKŁADZIE  
WSPÓLNEJ POLITYKI ROLNEJ*

**Key words: institutions, New Institutional Economics, institutional arrangement, Common Agricultural Policy**

*Słowa kluczowe: instytucje, nowa ekonomia instytucjonalna, porządek instytucjonalny, wspólna polityka rolna*

**Abstract.** The paper aims to present the importance that institutional arrangements play in the economic systems beyond the scope of one country. The authors attempt also to evaluate impact that the institutional arrangement of the European Union's Common Agricultural Policy plays for the development of agriculture and rural areas in Poland. The paper argues that institutional arrangement of mechanisms and instruments of CAP, especially of single market and financial solidarity, leads participants of this system to obtain additional value not only in form of financial benefits, but also in form of economic profits resulted from uncertainty avoidance of free market.

### **Introduction**

The use of the term institution has become more and more popular in the social sciences in recent years. It is due to the growth of significance of institutional economics and the use of the institution concept in several other disciplines, including philosophy, sociology, politics, and geography [Hodgson 2006]. Institutional system can be considered in terms of institutions (organizations) supporting the people and businesses operating in specific area or in terms of institutionalization (rules), which determines the activities of these institutions by identifying the principles and principles of their functioning [Gibbson 2005]. Such an institutional system reduces uncertainty and imposes certain way in which individuals proceed [Zalesko 2011].

Efficient institutional system plays important role in the development of agriculture and rural areas. The Common Agricultural Policy (CAP) can be considered as a unique system of aims and tools which requires the presence of a complex institutional background for its implementation. However, institutional environment (socio-economic factors, rural policies) is constantly changing. This is why the functioning of institutions may cause many ambiguities. This means that the creation of optimal institutional structures in the system of institutional arrangements, in the area of agricultural and rural development is an important task for the policymakers.

### **Objectives and methods**

The paper aims to obtain two goals. First it aims to present the importance that institutional arrangements play in the economic systems beyond the scope of one country, using the methodological approach of a New Institutional Economics. Secondly it aims to evaluate impact that the institutional arrangement of the European Union's Common Agricultural Policy plays for the development of agricultural and rural areas in Poland. In order to obtain the paper's objectives in depth literature review was executed and methodological approach of the New Institutional Economics was applied. The data considered for the analysis come from the secondary sources.

## Theory of institutions

The New Institutional Economics (NIE) is a broad and relatively new multidisciplinary field. It includes many scientific disciplines such as economics, sociology, business organization, law, history and political science. The phrase "New Institutional Economics" was created by Olivier Williamson but originally New Institutional Economics (NIE) emerged with Coase's 1937 article "The Nature of the Firm" and also with his essay "The Problem of Social Cost" (1960). Most of the researcher (including North) agreed that these publications were significant waves of revolution in economic thinking [Kherallah, Kirsten 2001].

It needs to be summed up, that the neo-classical economics depreciated the role of institutions [Ratajczak 2012, Kuder 2011]. It means that economic agents were considered to act in a vacuum. New Institutional Economics states that cost of transacting, determined by institutions, significantly impact on economic performance. In this respect it should be pointed out that the economic performance of the country depends on well-designed institutional systems (such as legal, political, and social systems). The NIE analyzes however institutions within the framework of neoclassical economics because the assumption of self-seeking individuals attempting to maximize an objective function subject to constraints still exists [Legieź 2013, Staniek 2006]. But at the same time some of unrealistic assumptions of neo-classical economics (such as zero transaction costs or perfect information) are rejected. Nabli and Nugent [1989] states that the objective of NIE is to explain the determinants of institutions and their evolution over time, and to evaluate their impact on economic efficiency and distributional implications.

Hodgson [2006] states that institutions are the kinds of structures that matter most in the social realm: they make up the stuff of social life. He suggest that the increasing significance of the role of institutions in social life involves the recognition that much of human interaction and activity is structured in terms of overt or implicit rules. There are many examples of institutions which includes for example money, language, law, systems of weights and measures and firms (and other organizations). In this line North [1990] wrote that institutions are the rules of the game in society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic. Williamson [2000] provided a distinction between different levels of institutions. He distinguished informal rules, formal rules and governance structures (institutional arrangements).

First level relates to informal rules such as implicit rules, customs, norms, practices, and habits that are followed by a certain group of society. They are commonly no written down and they are almost invisible. They do not play significant part of economic analyses. But informal rules can determine the success or failure of economic enterprises, such as markets [Eaton, Meijerink 2007].

Williamson [2009] states that formal rules encompass constitutional constraints, statutory rules, and other political constraints. Eaton and Meijerink [2007] mentioned that there are different formal rules with different functions. They said that formal rules promote exchange by (i) supporting exchange, i.e. the negotiation of agreements, or contracts between agents and (ii) in protecting property and persons. The set of formal rules can be sometimes referred to institutional environment. However the main difference between formal and informal rules is that informal institutions are related to private realm. Formal rules are often centrally designed and imposed [Williamson 2009].

Governance structures (institutional arrangements) are the combination of formal and informal rules, and their enforcement characteristics. They comprise the groups of individuals bound by some common purpose. There are many examples of economic bodies that can be viewed as institutional arrangements such as are firms, farms, and co-operatives, although organizations also include a wide range of political bodies, educational bodies, public bodies, etc. [Eaton, Meijerink 2007]. Hodgson states that organizations are a special type of institution, with additional features. He said that "organizations are special institutions that involve (a) criteria to establish their boundaries and to distinguish their members from nonmembers, (b) principles of sovereignty concerning who is in charge, and (c) chains of command delineating responsibilities within the organization" [Hodgson 2006].

In the institutional economics it is also recognized the approach that include the institutions into broader arrangements that influence the economic system as a whole. This approach distinguishes the institutional structures (institutional arrangements) and the institutional environment. According to Davis and North [1971] institutional environment is a fundamental system of political, social and legal principles, which establish the basis for production, exchange and distribution. In turn, the institutional structure is the scheme of cooperation between economic units, which manages the ways in which these units can cooperate or compete. Institutional structures are probably closer to the equivalent of the term “institution”. However, they must be designed so as to fulfill at least one of the purposes of: a) introduce a system within which the member may cooperate in order to obtain allowance of income, which is not available outside of the system; b) introduce a mechanism that may result in a change in the law or the rights of property designed to modify the acceptable methods by which the individual (or group) can legitimately compete with each other [Davis, North 1971]. Thus, the institutional structures are different kinds of rules that shape human behavior as traders and in turn the institutional environment provides a framework for the formation and functioning of the structures.

### **The framework of institutional arrangement**

There is no doubt today that institutions are important in stimulating economic development. Eaton and Meijerink states that institutions impact on the performance of the economy by their effect on the costs of exchange (transaction costs) and production. Costs of exchange (transaction costs) and production can be reduced by establishing the efficient institutions. Other factors, such as infrastructure and technology can help to reduce transactions costs too. However these factors (for example decision regarding improvement of the infrastructure) are embedded within institutions and social systems in general [Eaton, Meijerink 2007].

Molle states that institutional economics provides an argument for policy integration which aims at creation of a common policy framework that creates equal conditions for the functioning of the integrated parts of the economy [Molle 2005]. He stressed also that common policies require common institutions.

Several authors recognized the arguments for the centralization of institutions. These are: decrease of transaction costs, economy of scale, use of the spill-overs, creation of credibility and insurance [Leśniak-Moszczuk 2009, Muszyńska 2003, Falkowski, Milczarek 2006]. Vászary [2006] as well as Owczarczuk [2013] and Bisaga [2011] suggest that in agricultural policy the supranational institutions don't reduce the importance of national institutions, as some of the tasks are delegated to them. The decentralized national institutions are controlled by the common institutions (e.g. paying agencies) so they play an equally important role as the supranational institutions themselves.

### **The institutional arrangement of the CAP**

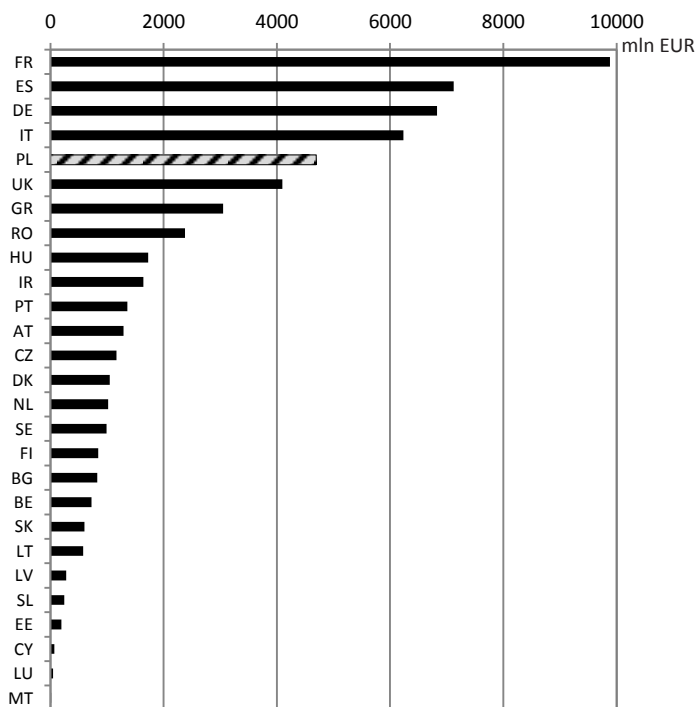
The Common Agricultural Policy (CAP) of European Union is an example of the set of institutions on multinational scale, which purpose is to generate the conditions allowing farmers to fulfill their multiple functions in society. In the European Union there was developed a set of specific regulations (formal institutions) as well as established the several economic bodies on the supranational level which often is recognized as institutional arrangements [source]. They could be recognized as an institutional system themselves, but this perspective is not covering the impact that is made on the economic performances on national level. Thus in order to capture the whole picture of the structure of the institutional arrangement there should be taken into consideration both supranational and national levels of institutions that govern the system of agriculture in the Member States. The critics of such approach will argue that i.e. on the agricultural system in the EU have significant influence also other institutions from international order, i.e. WTO regulations or UN agendas. These leads to the issue of complexity of institutions in the globalized economy. However in order to set up borders in the analysis the factor of comprehensiveness of the economic system needs to be taken into consideration. In case of the European Union its CAP should be

recognized as an open but coherent and comprehensive system that is governed by the arrangement of institutions on different levels.

The Common Agricultural Policy is the oldest common policy and one of the most important EU policies for both old and new member countries. In the heart of the institutional arrangement of the CAP are the mechanisms of single market and financial solidarity. Nowadays the CAP accounts for a majority of the EU budget (almost 40%) [European Commission 2013]. A majority of the member states in the EU resourceful use the agricultural funding they receive, which in turn contributes to promoting the economy.

Poland has become the one of the biggest beneficiary of CAP in the period of 2004-2013. Taking into account year 2012, Poland is on the 5<sup>th</sup> place in terms of total CAP expenditure (direct payments/ market measures/ rural development) (Figure 1). In the period 2007-2013 in the framework of Common Agricultural Policy it was invested more than EUR 25.1 billion euro (in current prices) in Poland's farming sector and rural areas. It includes total expenditures for direct payments, market measures and rural development. There have been several objectives of this support such as stabilizing farmers' income, modernizing and increasing the sustainability of Polish farms and securing the supply of safe, affordable and quality food for its citizens [Overview of CAP... 2013].

Direct payments were significant support for farmers income in Poland where agricultural sector provides 12.6% of jobs. In 2012 Poland spent over EUR 2457 million on direct payments for more than 1.3 million beneficiaries, 64% of whom received a payment below EUR 1250. What is more the injection of public resources into the farming and forestry helped essentially in attenuating the effects of the current economic crisis in Poland's rural areas. In the opinion of the European Commission, the evolution of the Polish agro-food industry was positive. There are two main changes: increase in output and significant growth in exports which is much higher than in other Polish economic sectors. One of the most important success of Polish agricultural sector is the growth in exports of agricultural products from Poland to other EU countries: in the last ten years it has been multiplied by five and Poland has continued to be a net exporter of agricultural products [Factsheets on CAP... 2014].



The rural development policy aims in providing support for strengthening rural production, its institution and environment. For the period 2007-2013 it was based on three main elements: improving agricultural competitiveness, improving the environment and supporting land management and improving the quality of life and diversifying the economy in rural areas [Kundera 2013].

Figure 1. CAP expenditure by Member State (EU-27) in 2012  
Rysunek 1. Wydatki WPR w krajach członkowskich w 2012 roku  
Source/Źródło: [Factsheets on CAP... 2014]

Despite the fact that the Common Agricultural Policy has a unified character, the amount of funds allocated to each instruments is different. This condition results from historical factors and the different objectives of the various forms of support. This is why, in the EU-15 countries direct payments, which are primarily a form of compensation for losses incurred as a result of reducing market support, play a crucial role. For this reason, they are allocated mainly to regions with a strong agriculture, where these losses could be potentially greater (Fig. 2).

In Poland and also in the EU-12, payments under the rural development policy (second pillar of the CAP) are more important, which is associated with their cohesive function. This function involves the financing of projects aimed at reducing disparities between the levels of development of rural areas in different regions. This is why, the payment of the second pillar account for nearly half of all CAP funds in Poland [Poczta 2010].

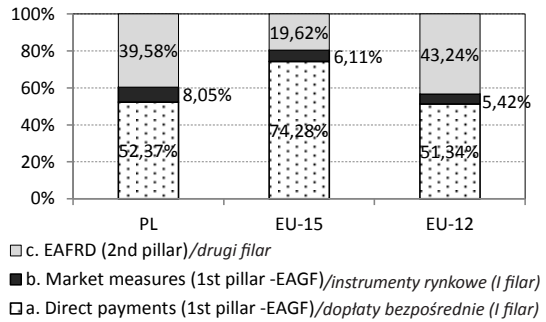


Figure 2. Distribution of CAP expenditure in 2012

Rysunek 2. Dystrybucja wydatków WPR w 2012 roku

Source: see fig. 1

Źródło: jak na rys. 1

## Conclusions

According to the New Institutional Economics it can be assumed that economic performance of the country depends on well-designed institutional systems. Together with participation of the country in the international agreements, such the European Union, the institutional system is enlarged on mechanisms and instruments that govern the economic performance. Such arrangement of mechanisms and instruments leads participants to obtain additional value not only in form of financial benefits, but also in form of economic profits resulted from uncertainty avoidance of free market. An example of such institutional arrangement could be observed with regard to the Common Agricultural Policy, which mechanisms and instruments allowed Poland to generate significant development of agriculture and rural areas.

## Bibliography

- Bisaga A. 2011: Środowisko instytucjonalne i struktury współzarządzania rolnictwem w strategii rozwoju regionalnego, Prace Naukowe Uniwersytetu Ekonomicznego w Katowicach, Rocznik 2011, Wydawnictwo Uniwersytetu Ekonomicznego w Katowicach. Katowice.
- Davis L.E., North D.C. 1971: *Institutional Change and American Economic Growth*, Cambridge University Press, Cambridge.
- Eaton D., Meijerink G. 2007: *Markets, institutional change and the new agenda for agriculture*, Markets, Chains and Sustainable Development Strategy and Policy Paper, no. 6, Stichting DLO, Wageningen.
- European Commission – EU budget. 2013: available at [http://ec.europa.eu/budget/figures/2013/2013\\_en.cfm](http://ec.europa.eu/budget/figures/2013/2013_en.cfm), read 12.09.2014.
- Factsheets on CAP achievements in Member States. 2014: Directorate-General for Agriculture and Rural Development, available at: [http://ec.europa.eu/agriculture/cap-in-your-country/index\\_en.htm](http://ec.europa.eu/agriculture/cap-in-your-country/index_en.htm), read 12.09.2014
- Falkowski J., Milczarek D. 2006: *Are macro policies adjusted to institutional arrangements at the micro level? Some evidence from Polish Agriculture during transition*, [in:] J. Curtiss, A. Balmann, K. Dautzenberg, K. Happe (ed.), *Agriculture in the Face of Changing Markets, Institutions and Policies, Challenges and Strategies*, IAMO, Halle.
- Gibson R. 2005: *For formal (izable) theories of the firm?* Journal of Economic Behaviour and Organization, vol. 58.
- Hodgson G.M. 2006: *What are institutions?* Journal of Economic Issues, vol. XL, no. 1, March 2006.

- Kherallah M., Kirsten J. 2001: *The New Institutional Economics: applications for agricultural policy research in developing countries*, Markets and Structural Studies Division International Food Policy Research Institute, MSSD Discussion Paper no. 41, June.
- Kuder D. 2011: *Instytucjonalizm wobec głównego nurtu ekonomii*, Studia Ekonomiczne nr 80/2011, Wydawnictwo Uniwersytetu Ekonomicznego w Katowicach, Katowice.
- Kundera J. 2013: *Poland in Common Agricultural Policy*, International Journal of Agricultural Extension, vol. 1, no. 1.
- Legiędz T. 2013: *Nowa Ekonomia Instytucjonalna a zmiany paradygmatu rozwoju gospodarczego*, *Economia* nr 4(25), Wydawnictwo Uniwersytetu Ekonomicznego we Wrocławiu, Wrocław.
- Leśniak-Moczuk K.: *Współczesne problemy dostosowań instytucjonalnych w skali globalnej, krajowej i regionalnej*. Nierówności Społeczne a Wzrost Gospodarczy nr 14/2009, Wydawnictwo Uniwersytetu Rzeszowskiego, Rzeszów.
- Molle W. 2006: *The economics of European integration – Theory, Practice, Policy*, Ashgate Publishing, Ltd.
- Muszyńska K. 2003: *Rola instytucji w procesie kształtowania rozwoju sektora rolno-żywnościowego w Polsce*, Zesz. Nauk. AE w Poznaniu nr 30, Wydawnictwo Akademii Ekonomicznej w Poznaniu, Poznań.
- Nabli M.K., Nugent J.B. 1989: *The New Institutional Economics and Its Applicability to Development*, World Development, vol. 17(9), 1333-1347
- North D.C. 1990: *Institutions, Institutional Change, and Economic Performance*, Cambridge, Cambridge University Press.
- Overview of CAP Reform 2014-2020*. 2013: DG Agriculture and Rural Development, Unit for Agricultural Policy Analysis and Perspectives, no. 5, December 2013.
- Owczarczuk M.: *Zmiany instytucjonalne w gospodarce – wybrane aspekty teoretyczne*, *Optimum*, Studia ekonomiczne nr 2(62) 3.
- Poczta W. 2010: *Gospodarstwa rolne w Polsce na tle gospodarstw Unii Europejskiej – wpływ WPR, Powszeczny spis rolny 2010*, GUS, Warszawa.
- Staniek Z. 2006: *Czynnik instytucjonalny w różnych nurtach teorii ekonomii*, *Kwartalnik Historii Myśli Ekonomicznej* nr 2-3, Szkoła Główna Handlowa, Warszawa.
- Ratajczak M. 2012: *Ekonomia instytucjonalna i jej współczesny podział*. Zeszyty Naukowe Uniwersytetu Szczecińskiego. Współczesne Problemy Ekonomiczne, nr 4/2012, Wydawnictwo Uniwersytetu Szczecińskiego. Szczecin.
- Vásáry V. 2006: *The Common Agricultural Policy in relation to Institutional Economics*, *Gazdálkodás*, vol. L, Special edition no. 17, 35-46.
- Williamson O.E. 2000: *New Institutional Economics: taking stock, looking ahead*, *Journal of Economic Literature*, vol. 38, 595-613.
- Williamson C.R. 2009: *Informal institutions rule: institutional arrangements and economic performance*, *Public Choice* 139, 371-387.
- Zalesko M. 2011: *Ocena instytucjonalizacji rynku rolnego w kontekście Strategii Rozwoju Kraju 2007-2015 i kierunku reform Wspólnej Polityki Rolnej*, [in] D. Kołodziejczyk, M. Gospodarowicz (ed.), *Ocena dostosowania systemu instytucjonalnego działającego na rzecz obszarów wiejskich i rolnictwa do Strategii Rozwoju Kraju i kierunku zmian WPR*, Instytut Ekonomiki Rolnictwa i Gospodarki Żywnościowej – PIB, Program Wieloletni 2011-2014, 12.

### Streszczenie

*Celem artykułu było wskazanie, jaką rolę odgrywają rozwiązania instytucjonalne w systemach gospodarczych, które wykraczają poza zakres jednego kraju. Podjęto się także oceny wpływu porządku instytucjonalnego wspólnej polityki rolnej Unii Europejskiej na rozwój rolnictwa i obszarów wiejskich w Polsce. Stwierdzono, że porządek instytucjonalny WPR, stworzony głównie z mechanizmów i instrumentów regulujących rynek i wdrażających zasadę solidarności finansowej, prowadzi uczestników tego systemu do uzyskania dodatkowych korzyści nie tylko w postaci korzyści finansowych, ale także w postaci zysków gospodarczych, wynikających z ograniczenia niepewności wolnego rynku.*

Correspondence address

Dr Mariusz Maciejczak, mgr Paweł Grzelak  
Warsaw University of Life Sciences – SGGW, Faculty of Economic Sciences  
Nowoursynowska St. 166, 02-787 Warsaw  
e-mail: mariusz\_maciejczak@sggw.pl, pawel\_grzelak@sggw.pl