

## STUDIES

### TRUST, SOCIAL NETWORKS AND THE INFORMAL ECONOMY: A COMPARATIVE ANALYSIS

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**Abstract:** In this study we will attempt to show that trust is a cultural concept that should be ethnographically described, as its meaning varies according to the culture of each society and in every particular situation. Trust is a central component of social solidarity and the cement used to produce cohesion within the social networks composing the structure of society. Social networks based on trust might allow individuals to cope with the imperfections of a given socioeconomic system (state or market dominated), but they might also serve to erode the institutional framework of states by facilitating less desirable transactions (corruption). Hence, social networks may have positive connotations for those who benefit from having social networks or negative consequences both for individuals that lack such networks and for the formal institutions of society. To understand the complex variations in the construction and political impact of these social networks we analyze its role in the informal economy of three different socioeconomic systems. Following our previous studies, (Lomnitz 1971; 1988) we will discuss the importance of social networks based on trust and loyalty for the economic and social survival of the middle class in Chile. We will compare it to the informal economy in the former Soviet Union and, finally, drawing from literature on post-socialist societies, we will discuss the role of social networks in the transition to a market economy. In Latin America social networks have become the means on which informal activities take place allowing the poor to survive physically and the middle and upper classes to maintain their social status and privileges. In communism, the use of personal connections (social networks) has been recognized as a central strategy to satisfy shortages derived from the inefficiencies of the system, and as an important legacy with tremendous consequences for the post-socialist regimes that followed. In this article, we attempt to show the universality and persistence of trust-based networks as well as its socio-cultural embeddedness and the ambivalent consequences they have on state and society.

**Keywords:** social networks, trust, loyalty, informal economy, solidarity

## TRUST

We understand “trust” or confidence as a social concept whose meaning is culturally determined and therefore it should be ethnographically described, as it does not have the same meaning in different societies and for different situations (Rose-Akerman 2001: 420; Lomnitz 1977: 196). In general, trust is a central component of social solidarity and the cement used to produce cohesion within the social networks that compose the structure of society (Simmel 1964: 318).

Trust can be defined as the real or effective psychosocial distance between individuals. It is associated with social closeness in the sense of sharing the same categories of expected rights and duties, plus shared values and interests. An individual feels confidence in another when s/he trusts the other to have the ability, the desire, and the good disposition to perform an exchange, or when his/her own familiarity with the other allows him/her to make a request. Another form of expressing trust is the act of volunteering an item or personal information of an intimate character, thus implying confidence in the discretion and friendly disposition of the other person. “Trust then, is a relational response, not a result of blind loyalty that permits people to take risks in dealing with each other.” (Rose-Akerman 2001: 543) “Trust is a particular level of subjective probability with which an agent assesses that another agent or groups of agents will perform a particular action [...]. When we say that we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial, or at least not detrimental to us, is high enough for us to consider engaging in some form of cooperation with him.” (Gambetta 1988: 207).

Trust regulates the nature and type of resources that can and should be interchanged; it assigns positions and provides friendships with symbolic content. Trust is not easily stored up; it is lost and won, given and taken away. Sometimes individuals fight for more trust, at other times they try to shake off the trust they have. Trust integrates and discriminates between individuals and types of behavior; it determines privileges and induces loyalties. Trust mobilizes resources and is an active principle in the rules of solidarity.

In short, trust is the basic, subtle, ineffable criterion that sets out the distinctions and boundaries between the “close friend”, the “friend”, and the “acquaintance”. The mental map of friendship is basically a map of rankings of trust, rankings that, in the last resort, reveal the true social distances between individuals in profoundly dynamic friendship networks. A friend, for example, can go back to being an acquaintance if s/he fails to maintain the expectations that won him/her his/her initial position on the scale of social distances. An acquaintance can become a close friend that is to say he/she can accumulate trust by rendering a particularly worth-while service or by being the repository of trust.

No society can function without a minimum of trust among its members. In small and pre-modern societies, individuals characteristically relate repeatedly with the same persons in practically all situations. The networks that use to acquire things are primarily informal, face-to-face associations of people. Members of small societies tend to move within culturally prescribed roles, and these roles include the

specification of mutual assistance. Everyone knows who is to be trusted and who is to be approached for help; confidence and trust is implicit in the social relation. As a society grows and becomes more complex the social, economic and occupational mobility of its members increases and the total roles found in small societies become fragmented. In an ideal modern society where collective action is institutionalized, the individual is led increasingly to depend on formal institutions and informal interpersonal networks are relegated to certain areas such as affective aspects of social life (kinship, friendship). In this situation, trust (between individuals and institutions) acquires another meaning different to the one related to personal bonds. Therefore, it becomes necessary to distinguish between “horizontal trust” (i.e. trust in others) and “vertical trust” (trust/confidence in institutions), that is, “trust in the impartiality and fairness of institutions and trust in the partiality and favoritism of one’s close friends and relations” (Eek and Rothstein 2001; Rose-Akerman 2001).

In this paper, we claim that the use of social networks based on interpersonal trust (“horizontal trust”) is not a residue of “pre-modern” societies but an intrinsic element of complex modern societies insofar as it constitutes the response to the inadequacies of institutionalization. Social networks have shown to play an important role within the urban poor of underdeveloped capitalist countries where the state and market have failed to adequately insure the satisfaction of needs of all members of society. In such marginalized sectors, it becomes vital for an individual to enjoy the support of a social group for which s/he feels sufficient trust to rely on it for major emergencies as well as for the satisfaction of its most immediate needs. Interpersonal trust is the prerequisite for flows of exchanges of goods and services to take place. These reciprocal exchanges constitute the basis of an informal economy organized around trust-based social networks, which allow the poor to acquire the minimum necessary for their survival. We could say that in this case trust has a positive connotation as it is a mechanism of integration used by the poor to cope with their socioeconomic disadvantages. (González de la Rocha 2001; Lomnitz 1977, 1978, 1982).

There is, however, a different aspect of the use of trust-based networks. In a previous study, Lomnitz (1988) proposed to examine the pervasive utilization of informal exchange social networks *within* the formal sector itself. The exchanges analyzed included various forms of trading influence and bureaucratic favors for equivalent services or material rewards. She concluded that depending on the political system, some forms of informal exchange were tolerated, while others severely repressed. Even in the latter case, illicit economic activities within the state bureaucracy were often seen as inevitable (if not actually useful) by members of elite groups within the formal system. In this study, Lomnitz showed that informal activities based on personal connections are not random or chaotic; on the contrary, they constituted a system of exchange based on interpersonal trust and loyalty that run underneath and parallel to the formal administrative rules.

The Weberian analysis of the rationality of bureaucratic systems ignored the informal activities that sprang up within formal organizations as a response to the malfunctioning of bureaucracies. However, social scientists based on first-hand observations have developed an extensive literature focusing on the discrepancies between the goals and structures of formal organizations and the historical and cultural

specificities of the social systems in which those organizations are embedded. The main consequences of this conflict appear to be inefficiencies resulting from rigidity and corruption. Personalistic, culturally determined loyalties to kin and local groups, that is, trust on interpersonal networks often defy the more nationalistic ideologies that underlie bureaucratic rationality.

In this paper, we will relate formal institutions of society with interpersonal networks through which informal exchanges are realized. Informal economic activities have been defined as those which escape state regulations both on production and distribution of goods and services and on the nature of their final objective (legal, illegal or criminal) (Castells et al. 1989: 12). Informal exchanges are possible through social networks based on cultural institutions such as family, friendship and other relations in which *trust* and loyalty among its members is the underlying principle. We will review three examples showing the different roles of trust-based networks in the informal economy: an informal exchange of bureaucratic favors in Chile where the role of the state was regulating and distributing social services; in the Soviet Union, where all production and distribution of goods and services were under state control; and in post-communist transitional societies where the introduction of a market-dominated economy has weakened the state and informal economic activities based on the utilization of “network capital” seem to have flourished (Sik 1994).

### TRUST: THE ROOTS OF INFORMALITY

In an ethnographic study on the Chilean middle class Lomnitz found (Lomnitz 1971; Lomnitz and Melnick 1991) a culturally defined system of exchange euphemistically called “*compadrazgo*” (alluding to the closeness that god parenthood implies in the Catholic church),<sup>1</sup> which was based on trust between individuals. This system involved a continuing exchange of complementary services (“favors”) performed and motivated within an ideology of friendship. Such favors were often of a bureaucratic nature and usually involved giving someone preferred treatment and therefore setting aside the rights and priorities of third parties, or of the community as a whole. An informant defined *compadrazgo* as a form of assistance used “to obtain something with greater ease and in less time”. He pointed out that “the objectives are usually legal, though the means may be less so.”

*Compadrazgo* is a tacit dyadic contract or chain of such contracts involving common friends acting as go-betweens. Essentially, this system was egalitarian in that it presupposed that all members of the urban middle class had access to social connections within the civil service hierarchy; “everybody has friends and relatives”. Favors dispensed to friends and relatives within such a system included:

*Job placement.* In a situation of job scarcity and danger of status loss through manual labor, it is not surprising to find the *compadre* valued as the first and last resource of livelihood. The actual process of job hunting consists in reviewing

1 Today the same institution is called “pitutos” (plugs) and it has different names in different societies such as “palanca” (leverage) in Mexico, “contactos” (connections), “cuña” (wedge), “sociolismo” in Cuba, “guanxi” in China, “protexia” in Israel, “blat” in the Soviet Union, etc.

mentally all one's personal connections in order to locate someone who is close to the source of appointments in a given agency. Conversely, finding a person for a job opening involves going over the list of one's relatives and friends in the hope of discovering someone suitable.

*Bureaucratic favors* are the most common use of *compadrazgo*: acquiring certificates, licenses, transcripts of documents, passports, permits, identity cards, tax clearances, and countless other red-tape items which would otherwise require many mornings spent standing in line and chasing paperwork from one office to another.

*Loans*. The scarcest of all resources at the time was money. Borrowing was often beyond reach of the middle class because of the high collateral required. A well-placed friend in a bank or credit association facilitates matters. A *caja* is a credit union operated under the social security system; it is supposed to provide loans, but is chronically short of funds. As soon as fresh funds for loans become available, the *compadre* is notified ahead of the public and his application is then guided to the top of the pile to get it processed before the funds are exhausted. This is a typical use of *compadrazgo*, a situation in which people in key positions give their relatives and friends confidential tips based on inside *information*. None of this appears to the practitioner as strictly illegal since "no harm is done except to the people waiting in line, everyone of whom would have done the same if he'd had the right connection".

*Schools*. Admission to the better schools, both public and private, is difficult because of the tremendous demand for places at the few establishments of top reputation. Any *compadre* who works at one of these good schools, or who has friends who do, may be in a position to perform a vital service, which elicits considerable gratitude.

*Legal favors*. According to a lawyer informant there is no end to the use of *compadrazgo* in legal matters. For example, files can get conveniently lost, charges are suspended or sidetracked, witnesses are coached, fines or bail are set at minimal levels.

*Social introductions* to persons who control access to jobs or whose acquaintance is seen as desirable and potentially useful is another example. Invitations to dinner parties are often used for such introductions and are therefore reckoned as important favors; widening the circle of one's friends and acquaintances is essential to success in all walks of middle class life.

*Waiving of priorities* is getting a number of scarce items for which there are long waiting lists: telephone service, buying a car at wholesale price, scholarships and grants, service commissions abroad, and so on.

*Politics*. Many informants believe that the Chilean party system is based largely on *compadrazgo*. Certain well-known politicians started on the basis of a personal following of people who owed them favors. (Lomnitz 2001)

The preceding list of services obtained through *compadrazgo* is, of course, always conditional on having the right friends in the right place at the right time. No person is ever in a position to use *compadrazgo* in every situation that arises. The essential point is to have as many friends and connections as possible. Hence the tendency, which has become a mental habit, to look for a *compadre* before undertaking anything at all.

What cannot be obtained through *compadrazgo*? According to informants "anything that goes against the ideology of friendship and 'decency'". Sexual

advances made by a man because of granting a favor to a woman would be regarded as extremely gross behavior. Any behavior that infringes middle-class standards: theft, murder, taking advantage of women or other defenseless persons, and in general acts against dignity and “chivalry”. Such acts would destroy the rationale of friendship by degrading it to complicity. *Compadrazgo* has a moral code which sets boundaries on permissible favors and return payments.

Favors obtained under *compadrazgo* were rendered without material compensation of any kind. Yet according to an informant “the person conferring the favor is always aware of future benefits which may accrue to himself, or to some relative or friend”; it is a debt of honor that may be payable at any time.

Material payment in return for favors is graft. It means the absence of any possibility of a personal relationship or of having friends in common. Accepting a bribe is an acknowledgment of social inferiority, like accepting a tip or gratuity. The major resource of the middle class is the control of public and private administration; thus, in this case, the system of exchange of favors amounts to a system of mutual solidarity essential to the survival of the networks that compose the middle class. It presupposes between the partners of the exchange a special kind of psychosocial closeness, which is called *confianza* in Spanish (Lomnitz 1971: 102). This refers to the kind of trust that must exist toward a person of whom one is about to request a given favor or service. If the required degree of *confianza* does not exist, the favor may be requested through a third person that is on terms of *confianza* with both parties. This leads to the proliferation of reciprocity networks, initially based on kinship, since *confianza* normally exists between close kin, but frequently extends to include hundreds of people among friends and acquaintances.

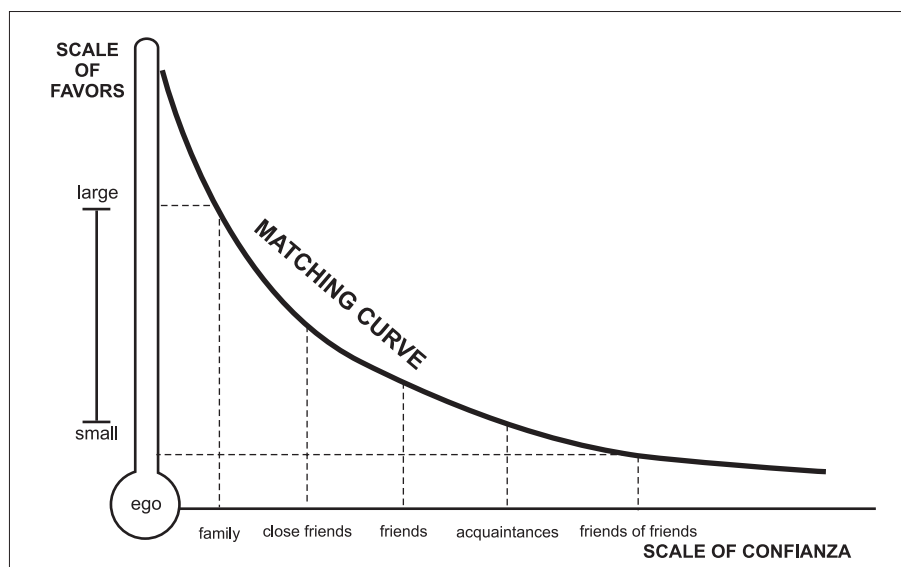


Figure 1. Scale matching favors with social distance (X-axis shows level of *confianza*, y-axis shows level of favors)

*Figure 1* represents the continuum of social distance as perceived by Chileans. Labels such as “intimate friends,” “close friends,” “acquaintances,” and so on are categories used by ego to classify relations. Individuals may be moved from one category to another, depending on the intensity of reciprocal exchange. The types of favor to be asked of a person depend on one’s social distance (or trust). It can be said that the practice of reciprocal exchanges is embedded in an ongoing social relationship and is determined, largely, by “intervals of sociability” (Sahlins 1963: 144).

### **Conflicts of Interests: The Dynamics of Informality**

Within the formal sector, trust-based interpersonal networks have generated a system of informal exchange. The individual official who defends and administers the system and who creates its laws and controls is simultaneously a member of a network of primary, culturally determined loyalty relations that include family and friends. How is this apparent conflict of interest resolved?

At the outset, it is necessary to point out that the conflict between formal and informal duties and obligations is not merely a conflict between community and individual, between public welfare and private interest. On the contrary, it is the conflict between rival ideologies, each of which is acknowledged and lays claims to the loyalty of the individual.

In the Chilean case, the formal system rests on the liberal ideology of fair play, equality before the law, and economic rationality, while the informal system is sustained by a complex of ideological components: chivalry, “noblesse oblige”, family, and group solidarity.

The conflict between rival ideologies is expressed in the rules of exchange that, though unwritten, are fairly strict. In addition to the general requirements of *confianza* and social equality, there are limitations on the kinds of favors requested and the manner (etiquette) of requesting them. Among the “dos and don’ts” we have noted the following: don’t request favors that might threaten a friend’s vital interests or the safety of that person’s job, don’t mix friendship and business, sentiment and profit; don’t be impatient, allow for your friend’s personal pace in complying with your request; phrase your request in terms that reflect your degree of *confianza* (see *Figure 1*). Thus, among friends who are on less than intimate terms, it is customary to present one’s case as a request for advice, thus leaving it up to the friend to offer assistance. Among close friends, such an indirect approach would be offensive, since it would imply casting doubts on a friend’s readiness to be of service. On the contrary, far from being demoralizing, compliance with the rules of sociability that surround relations of trust, whether toward a relative or a friend, acquire a quasi-sacred ritual character that compensates for the uneasiness the individual is liable to feel about the social system in general.

The requirement of social and economic equality can never be met exactly, nor can the resources available to each partner be the same, or there would be no motivation in the exchange. When a friend moves to a higher position, his or her friends may become aware of their limited power to reciprocate. They stop asking for trivial favors and

approach the person only when their request befits the person's rank. They may express their gratitude through personal and political loyalty; as a result there is a continuum of reciprocity that approaches patronage. Patron–client relations are a form of reciprocity, where benefits to subordinates are traded against loyalty and power.

Essentially, as the differentials in power increase between the partners of the exchange, the services of the more powerful partner are increasingly reciprocated through demonstrations of gratitude and loyalty. A hierarchy is not just an abstract organizational chart where posts are filled by mutually interchangeable officials - it may also be a network of patron–client relations. At each articulation, there is a downward flow of resources (employment, protection, bureaucratic patronage) in exchange for work and loyalty. The patron provides security of employment, political protection, and dependability in unexpected circumstances of need in exchange for loyalty, expressed through personal commitment to the patron in labor, political support, and ideological allegiance. The decisive importance of cultural variables such as loyalty and trust means that a patron-client relation, like reciprocity, is embedded in a long-term social relationship. In conclusion, the symmetry of the relationship depends on social distance: the closer the social relation, the greater the *confianza* and consequently the balance of the exchange. Among brothers, for example, there may be a power differential related to age and personality, or to the kind of resources controlled by each, but the exchange remains more symmetrical than for strangers. As social distance increases vertically across class boundaries, patronage loses its interpersonal character and changes into payoffs, or market exchange.

Of course, this means that formal economic and political systems become permeated by socio-cultural rules of sociability. These rules may or may not be compatible with dominant rationalistic ideologies that supposedly rule the formal system, whether it is called a liberal democracy, communism or a post-communist society in transition to a liberal democracy. In each case, informal exchange systems based on culturally conditioned forms of sociability have proven surprisingly adaptive and resilient in the face of modernization and changes in cultural values.

The formal systems of today cannot be understood solely on the basis of their organizational structure and administrative regulations or by-laws. Administrative decision-making should not be taken at face value. Behind many formal decisions there are reasons that are not formally acknowledged, some that concern primary moral principles of the culture (loyalty, *confianza*) as embodied in institutions such as the family or friendship, and others that follow the logic of private gain and may be considered as corrupt practices.

### **Secularization of Trust**

The preceding discussion is intended to show that the social context of informal exchange introduces ideological components that lend a moral character to the performance of the obligations derived from interpersonal trust. We are dealing with basic symbolic structures as related to primary solidarity. However, when interpersonal exchanges are bereft of its moral context, there is a secularization of the



institution of reciprocal exchange and its gradual transformation into market exchange.

Market exchange may arise when (1) a personal relationship between the partners is precluded because of class differences (it may also be the basis of a patron-client relation); (2) the state apparatus increases in size to an extent that makes it increasingly difficult for informal reciprocity networks to cover individual needs; and (3) the type of favor falls outside the category that can be justified within the ideology of friendship and family solidarity.

For example, among private business classes, certain bureaucratic favors were obtained through bribes (when necessary) because there was an explicit desire to draw a distinction between the social status of the businessperson and of the administrative official involved. On the other hand, should a similar need arise for a member of the state apparatus, it would be necessary first to make sure that the individual to be bribed does not frequent the same social circles. The case of Mexico is interesting because of the extent to which the form of administrative corruption called *mordida* (a “bite”) has become generalized throughout the public administration, from high officials down to the corner policeman. When a driver offers a bribe to a policeman, both know that the likelihood of their meeting again socially is negligible. However, when this is not the case, the transaction involves a certain etiquette, which increases with the rank of the person to be bribed. Face-saving devices include the use of formal intermediaries, charging the client an added “tax” or other nonexistent service charge.

This is not to say that all bureaucratic favors are settled through bribes as individual officials have also obligations with their personal networks. It is true that market exchange, in the form of administrative corruption, remains morally unsavory and many people abstain from it as a matter of principle, but the use of social relations for purposes of obtaining a favor has no such negative aura. In all cases moral standards of behavior are culturally conditioned and vary with each society. Therefore, the boundary between reciprocity and market exchange is a thin line. If corruption is strictly defined as “dishonest behavior that violates the trust placed in a public official” (Rose-Akerman 2001: 527) involving the use of a public position for private gain, how can we define the institution of *compadrazgo* and reciprocity exchanges of favors?

### **TRUST AND INFORMAL ECONOMY: THE CASE OF THE SOVIET UNION**

The effects of informal modes of exchange on society can best be appreciated where the formal system is more rigid and all embracing or monolithic. This is notably true for the socialist countries, where a centralized state apparatus ran politics, production, labor, and most commercial and cultural activities.

Economic planning was “an organic, fundamental feature of real socialism” and direct bureaucratic control was the major task of the *Nomenklatura* (the administration elite) (Voslensky 1978: 163). Under the classical socialist system, bureaucratic coordination was the mechanism applied most widely and forcefully. Although bureaucracy exists in other systems, classical socialism is the first system in history to

merge these partial bureaucracies into a single entity embracing the whole of society. The power elite, hierarchically structured and sharing power with no other groups had the exclusive right of disposal over the state-owned means of production. Within its own ranks it eradicated other coordination mechanism to the degree it was able and relied as much as it could on bureaucratic coordination. Relations between state-owned firms were not coordinated by the market, instead were bureaucratically coordinated through a vertical system of linkages (Kornai 1992: 97–98).

Unfortunately, the ideal rationality of planning was offset by the frequent irrationality of bureaucratic mismanagement, inefficient planning or by practices that were based on other forms of exchange (market and reciprocity). The result was a chronic shortage of consumer goods and other commodities due to inefficiency in production and distribution. The considerable inertia of the bureaucratic apparatus generated and encouraged waste, pilfering and negligence (Bahro 1978: 235–241; Kornai 1992: 228–301). In Gorbachov’s words strict planning and regulations limited initiative and produced a second economy:

*A serious fault of the political system was the statization of the social life. State regulations extended practically to all activities in society. The tendency to a total planning and centralized control of all aspects of life literally put a constraint in the country, limiting the initiative of people, organizations and collectivities, giving rise among other things to a “parallel” economy that took advantage of the inability of the state organs to satisfy people needs. (Gorbachov 1993: 11, our translation from Spanish)*

Those living in a socialist country experienced countless frustrations of thwarted purchasing intentions, queuing, forced substitution, searches for goods and postponements of purchases in their daily life as consumers and producers (Kornai 1992: 234). These deficiencies gave rise to informal solutions. The literature specialized on the former Soviet Union describes the most common forms of economic activities within the “shadow” or “second” economy as including professional or technical services rendered outside office hours; goods produced in the plant or shops but diverted for private sale; parallel production within state enterprises using diverted or surplus materials during off hours; private constructions teams (*shabashniki*); brokers who supply contacts, locate scarce supplies and handle merchandising (*tolkach*); various forms of bribery and most commonly informal exchanges of goods and favors based on interpersonal relations and trust (*blat*) (Grossman 1977, 1979, 1981, 1983a, 1983b; Simis 1982; Altman 1983; Kaiser 1976; Smith 1979, and others).

### **Blat: The Roots of Informality**

In the Soviet system, total welfare in the family was the sum of what could be obtained from a multiplicity of “second” economies that Katsenelinboigen (1978 quoted by Rose 2000: 37) has aptly characterized as a “rainbow-colored” system, since methods for producing or getting goods and services shaded into each other; they were

interdependent rather than separate. The three primary “colors” of the rainbow system were the official or modern economy, relying on legal, large-scale formal organizations such as state enterprises or pensions from the ministry; an uncivil or anti-modern economy in which individuals earned cash outside the reach of the national plan or by breaking rules about the allocation of goods and services; and social or pre-modern economies in which goods and services were produced within households and informal networks without any money changing hands (*ibidem*).

Ledeneva in her book *Russia's Economy of Favors* (1998) describes *blat* as an informal exchange system based on interpersonal bonds of trust by which individuals solve their daily lives' problems. *Blat* is characterized by a reciprocal dependence that engenders regards for and trust on the other over the long term; it is a non-monetary exchange that derives from and creates relationships. It takes place within a given community between people who interact on a regular basis. The specific character of *blat* as an exchange of “favors of access” is possible because it is embedded in private relationships, trust-based social networks, as the case of Chile described above. Reciprocity in *blat* relations is created and preserved by a mutual sense of “fairness” and trust, in which each side takes responsibility as the recipient both for his/her satisfaction and that of the other. People trusted each other because they knew one good turn deserved another and this was in their mutual interest.

*Blat* relations are predicated upon belonging to a personal network, that is, a relatively closed social circle. It was one of the most common features of everyday life that individuals routinely constructed, and were selectively recruited into. Social networks such as kinship and friendship were the principal social contexts within which ties to significant others were organized (Strathern 1981 quoted by Ledeneva 1998). Through these social networks, individuals gained not only opportunities for interaction but also access to resources.

As in the Chilean *compadrazgo*, in *blat* there are unwritten rules, which constitute the moral code of the exchanges. An untrustworthy person may lose his/her opportunities to be involved in the chains of relationships and thus fall out of the *blat* network. *Blat* relations were regulated according to the logic of informal relations, such as not cheating one's neighbor, “one should ask the right person at the right moment about the right thing”; money was not to be given or accepted, for it would deprive the relationship of a personal basis and insult the recipient; keeping contacts and sharing problems with friends so as to open the door for obtaining and offering help; and then in general: maintaining a *blat*-style or a skill of approaching people in a pleasant or promising manner: to obtain something by *blat* – in modest volume, with discretion, normally in situations of urgent need and within a closed personal circle – was a norm, to overcome its limits was theft and corruption (Ledeneva: *ibid*).

Comparing the two systems of exchange we have described, *compadrazgo* and *blat*, we can appreciate the similarities between them in that they follow similar cultural codes based on trust. However, one important difference is that the morality of *blat* relations did not exclude the logic of “beating the system” nor violating the rules for the sake of efficiency. Another difference is that the Soviet system featured a more extensive use of market exchange in the form of direct payments in return to administrative franchises than the Chilean system. It is also true that the Soviet system

had evolved a complex and rigid set of bureaucratic controls in which it became less likely to have “the right friend in the right place” for all needs; hence, personal interactions were increasingly replaced by money. However, even in the case of graft, there are underlying rules of sociability and trust due to the illegality of the transaction.

### **The Second Economy**

According to Grossman (1977, 1981, 1983b) it was difficult to estimate the share of the country’s total economic activity that corresponded to the second economy, since these activities were illegal and could not be monitored in conventional ways. O’Hearn (1980: 7–9) pointed out that as the second economy added to the aggregate supply of goods and services, it also siphoned off resources from the formal economy through thefts and diversion of manpower, thus contributing to the inefficiencies that generated informality in the first place. He concluded, “as long as the second economy exists as a corrective mechanism for the planned economy, there is no incentive to improve central planning” (1980: 229–231). This state of affairs contributed considerably to deteriorate the system since it ran counter to the system’s ideology and the formal functioning of the state.

The “second economy” branched out into most fields of economic activity. Private enterprises where outlawed, yet sprang up illegally in the consumer goods industries, in the marketing of quality farm and dairy products, and in luxury or high technology items. Eventually most goods and services became available in this fashion, thus further decreasing the incentive to make the formal economy work. For example, failures and delays in the distribution system had a serious effect on production. The director of an industrial concern depended on the punctual delivery of many essential materials and parts; otherwise, production quotas could not be fulfilled within the assigned period. The entire staff and workforce also depended on these deliveries for their promotion and bonuses. A typical solution was found by creating a managerial position within enterprises in charge of getting informally and on time the materials needed. Normally this position was occupied by a member of a particular ethnic minority individual who through his personal connections with other managers occupying a similar position and belonging to the same ethnic group would obtain the needed resources in exchange for another similar favor that he could get through his own social network. This situation encouraged the growth of an informal economy dependant on brokers and illegal suppliers. Repression of these illegal activities in turn stimulated the proliferation of controls that aggravated the situation. As a result, the formal economy never caught up with demand: shortage occurred not only at the consumer level but also in industry, where shortages in critical supplies and equipment interfered with production.

State officials engaged in production and distribution, professional and service personnel “moonlighted” in private to supplement their official incomes, and so on. Officials with access to bureaucratic decisions had valuable services to offer. Official controls increasingly took the form of bribes and other exactions in kind. As the system looked the other way, everybody sold or bought goods and services on the side, thus

diverting an increasing proportion of state resources into the second economy and channeling public resources for personal profit.

The following case study by Altman exemplifies the way the second economy operated in the Soviet Union and the importance that trust had in it. This study is the result of a reconstruction of second economy activities done among emigrants from the southern republics of the USSR, Georgia, Uzbekistan and Tajikistan, to Israel in the 1970s. Yet, his conclusions are not confined to these countries alone; cultural differences and regional specificities do not necessarily change the overall nature of the communist system (Altman 1989).

The central point of these studies is the recognition that the informal economy depends largely on social networks that are socially embedded and operate within a set of culturally prescribed rules: "Trust is a fundamental requirement in the operation of the second economy. A man's word has to be his bond". In Georgia, for example, there is an unwritten code of honor whose infringement is penalized by shame. Networks are based on partnerships between kin and close friends (family enterprises). Depending on social distance, other friends play roles as suppliers, brokers, retailers, and so on. Hence, the importance attributed to friendship and to feasts at which friends are entertained at great expense. "Networks dictate marital choices, are a prime allocator of resources, influence one's occupational options, dominate recruitment and career development and set the limits to the scope of expansion for enterprises, and may finally determine if, how long and in what way a man will spend time in jail for economic crimes" (Altman and Mars 1983: 4–6).

In the study on Georgian Jews, three industrial plants were described: a cookie factory employing 200 workers, a textile plant with a working force of 1,000, and a light metal industry with 100 workers. In each, the informal (illicit) output was three to four times higher than the formal production (according to the plan). The informal partners who ran the business were, in each case, the people who occupied the top administrative positions in the plant (director, production manager, etc.).

Illegal production of consumer goods presupposed the existence of a network of suppliers and distributors, as well as the connivance of inspectors and authorities at all levels. The fact that the industrial operations described by Mars and Altman were considered "quite safe" meant that a well-organized, reliable network of this kind existed. The operation included obtaining low official production targets, as well as a high wastage allowance, in order to accommodate the secondary production. The remaining materials were purchased on the black market, or were obtained through barter. Substandard quantities or qualities of ingredients were part of a common practice to help fulfill the quota and to have enough raw materials left over for informal production. Defective production ("seconds") was sold in bulk to members of the network. Vital supplies were obtained from government stores through bribes and payoffs. Labor had no access to production figures. Those foremen who were in the know earned higher salaries. Bookkeeping was systematically juggled. For instance, the production lines were in "maintenance" at times of peak illegal production. Payoffs to officials ranged from 3,000 rubles a year to the director of the State Planning Office, 1,500 rubles to the chief of police, and 500 rubles to the gatekeeper. Payoffs were in cash and were sometimes paid in monthly quotas. Politicians were bought off by

invitations to parties and by expensive gifts on special occasions, such as weddings. Consumer goods outlets stocked a few official lines that were sold at official prices, but most of the business was under the table.

In one case studied by Altman (1983) the store was licensed to sell 34 products but actually stocked about 40. Scarce items were sold only to favored customers (kin and friends). Quality merchandise for black market sales was obtained through the network of brokers throughout the country. Unofficial transporters conveyed fresh produce directly from the village to the retail outlet, avoiding the clumsy official distribution system. To prevent complaints and denunciations, there was an element of trust between merchant and customer. Inspectors and police were bought off. The jobs themselves (factory director, store manager, Party secretary) were auctioned off to the highest bidder. In case of trouble (e.g., blackmail, periodic police raids, infiltration by agents as clients, and so on) the brokerage network functioned as a network of mutual assistance to bail out any threatened member and to obliterate incriminating evidence. Large sums of money were quickly assembled. In one case, more than 70 people were contacted in order to secure the release of an arrested person. Response in crises was the test of the network. Usually an experienced member of the network was appointed as negotiator or representative to solve the crisis at the local level before it spread to higher levels.

When the First General of the Georgian Communist Party was purged, many of the networks broke down. Too many vital links in the parallel economic system had been arrested or removed. It would have taken years before new networks of suppliers and cooperating officials could be built up. The Jews were usually dependent on non-Jewish top officials in the Party and police structure. Thousands of them decided to migrate to Israel when Khrushchev came to power and changed the Georgian chairman of the Communist Party who therefore replaced the leading Party and State officials throughout the Republic including key individuals who supported most of the operators of the Jewish networks.

In conclusion, trust-based informal networks were essential to the operation of the second economy in three ways: (1) as a power base for the allocation of scarce resources and the opening tip of new economic opportunities, as well as access to promotions, educational opportunities, and other scarce services; (2) as a collective security device against threats from the formal system and (3) as a pool of resources, particularly during emergencies. The larger the network, the more secure and profitable it was, and the more it could grow (Altman 1983: 945). At the same time, informal networks became in the last decades of communism, a fundamental asset within the formal economy, particularly for a new group of managers which recognized the significance of informal ties in the interest of their company and, of course, of themselves. In this sense, managerial socialism served as a place for the *original accumulation of informal network assets*, which after 1989 became a crucial feature of the transformation as the structure of their informal ties determined not only personnel selection for top managerial positions but also the shape of the economic organization. In socialism, informal social networks which included reciprocal exchanges between social and economic equals, patron–client relationships including political cliques, and market exchanges, became the way of doing things. In every instance, including in market exchange, trust was a basic element.

As we saw, the Soviet second economy complemented the formal economy helping it to achieve some of its formal goals as determined by central planning. However, it also distorted the basic assumptions of the communist state affecting the entire socioeconomic paradigm from the original design. As Altman (1989) pointed out just before the collapse of the Soviet Union:

*Like Janus, the twin-headed Roman God, the Soviet socio-economic system has developed over the years two distinct identities, both stemming from a joint core which holds the keys to the future of the USSR. The recurring question...is whether the Soviet system will eventually collapse under the strain of the enormous disparities between the two economies (formal and second). The evidence, however, suggests a symbiotic coexistence. There is no apparent structural reason why a thriving second economy should uproot itself from the fertile ground in which it thrives. And why should the formal economy give up the very many important services it receives through the second economy? But the question remains: is the social and moral price of such coexistence too high to pay? Gorbachov's current glasnost policy seems to indicate that it is indeed too high.*

The dramatic changes in the USSR initiated by Gorbachov, under the banners of Perestroika and Glasnot, were directly instigated by the challenge of the informal economy to the formal system. Gorbachov himself said so on many occasions. The presence of a second informal economy was crucial to weaken the state. The informal economy in the Soviet Union fed on the formal structure of society, while it helped the formal economy to run; it also weakened it to the point of collapse. The prolonged economic crisis brought Gorbachov to power: "without the economic crisis there probably would not have been the Gorbachov phenomena" (Saxonberg 2001: 129) and with it, the collapse of the Soviet Union and of the communist regimes of its allies.

## THE NETWORK ECONOMY IN POST-COMMUNIST SOCIETIES<sup>2</sup>

Studies in post-communist countries offer examples of the development and maintenance the informal economy has had in the transition from centrally planned to market exchange economy, and at the same time the importance that social relations based on trust have had in that process.<sup>3</sup> The persistence of an informal economy based on social networks in post-communism can be explained through its cultural heritages and historical and political developments: successful resistance by large segments of society to the socialist state insistence in making the large and highly formalized organization of the industrial firm the dominant mechanism of social life; the recent history of the second economy as a strategy of earning auxiliary incomes and through informal networking and the avoidance of law and other formal rules and regulations.

2 In this section, literature from specific post-communist countries is used to prove a general point about social networks in an ideal type of post-communist society.

3 Stark, Sik, Ganev, Böröcz, Rose, Ledeneva, Lonkila, and others.

Moreover, managerial socialism served as a training ground and a place for the original accumulation of informal network assets (“network capital”<sup>4</sup>) for informal and managerial elite action. Finally, the endemic capital shortages “which have created the necessary structural conditions and some serious individual and group-level incentives for the substitution of informal solutions for the formal organizational procedures that only large capital investment can produce” (Böröcz 2000: 368; Sik 1994).

As an example, in Bulgaria, Ganev (1999) argues that the state’s lack of capacity to launch regulatory intervention is caused by a form of elite action – networking which takes place in a specific structural environment best captured by the notion of embeddedness of the post-communist state. Networking then is likely to emerge as a dominant form of coordination in a situation where the hierarchical nexus of the centrally planned economy no longer exists, and where markets are yet to emerge. Ganev interprets the process of state transformation from communism to post-communism through the examination of the dominant predatory elite project after 1989 which he calls “extraction from the state”, stressing the decline of state capacity as the dominant aspect of post-communism. “Powerful networks involved in this project pray upon the wealth accumulated on the state domain. Fully capable of mobilizing flow of resources within the institutional edifice of the state, these elites have no incentive to develop strong state structures, quite on the contrary, undermining key institutions from the inside is necessary for the success of their project.” (Ganev 1999: 241).

Ganev exemplifies the dynamics of transition through the analysis of Multigroup, the strongest economic conglomerate in Bulgaria after 1989. The dynamics, which propelled Multigroup to the highest peaks of economic and political power, have been and continue to be the exploitation of “market niches” deliberately created or “voluntarily vacated” by the state. The most interesting characteristic of the business relationships with state-owned enterprises is that the state comes out as a perennial loser and its “partner” pockets all the benefits of “networking”. The logic of Multigroup’s enrichment is the logic of the state’s impoverishment. The focus remains constant: re-directing the flow of resources from a circuit operating within the confines of “state-run institutions” to a more open-ended cycle with several “privatized” outlets. Multigroup’s high-ranking officials relied exclusively on the expertise of former communist state officials who had occupied various sensitive positions within the communist state. Its President was married to the daughter of the director of Military Counter-Intelligence, which gave him access to networks comprised of secret service officials and other insiders from the state administration. The “first break” of the group was to buy an old Russian submarine, cut it to pieces and sell it to a Turkish metallurgical plant, suggesting a connection to a network of arm dealers spanning several countries. The vice-presidents and general directors of the expanded

4 Sik proposes to use the term “network capital” to define “any type of personal network and its use in all sorts of functions and according to any kinds of principles. In other words, network capital includes long-term altruistic kin relations, balanced reciprocity, lasting and multipurpose patron-client relations, instrumental barter, as well as corrupt exchanges” (1994: 74). For Sik, the size of an economic actor’s network capital is equal to the sum of the existing networks which that actor is able to mobilize when needed.



conglomerate where all former heads of the most powerful department of state security as well as heads of strategic departments of the ministry of internal affairs which included the department of information and analysis. Others were former directors of state-owned enterprises (oil industry, industrial investment and micro-processing) and eight were former deputy-ministers who served under the *ancient regime*. In other words, Multigroup created an environment in which “stored knowledge” about the Bulgarian economy was utilized. The biography of Multigroup’s strongmen suggests that it is the ways in which individuals are “connected” to networks which control access to scarce resource that really matters when it comes to comprehending the dynamic of “economic reforms”- their personal, cultural, religious, ethnic and psychological predispositions may be considered as spuriously significant attributes (Ganev 1999: 119).<sup>5</sup> On the same tone, in *Globalization and Its Discontents*, Stiglitz argues that the failure of the privatization process gyred by the IMF in post-communist Russia was due to the fact that enormous amounts of economic assets were transferred to a society which lacked the formal institutions capable of handling and monitoring such transactions. The result of the first stage of privatization has been to give away the nation’s assets to what amounts to a new criminal elite (Stiglitz 2002: 133–166).

Joseph Böröcz for the case of Hungary claims that social contacts became a most important asset in the transition. “Former state-socialist managers’ informal social networks became such a crucial feature of the transformation that the structure of their informal ties has determined not only personnel selection (top managerial) but also the shape of economic organization” (Böröcz 2000: 351). Informal social networks assets of key managers held together and provided coherence and consistency to the reform-oriented economy. “What went on in these informal arrangements among managers, administrators, planners and regulators was [...] akin to a symbolic and moral economy of favors, prestige, privilege, friendship, lobbying, clique, coalition, building and group action” (*ibid*: 365). According to Böröcz “the most important aspect of the post-Stalinist state socialist legacy is the privileged role of informality –a tendency of fundamental political, economic and social structural transformations to take place “behind the scenes”, outside the realm of public regulation, record-keeping and scrutiny. Informality, so conceived, has played a crucial part in most processes of transformation seen so far” (Böröcz 1993: 99).

According to Böröcz, in Hungary two principal forms of values were used in the process of privatization: the first one was foreign capital through direct investment, the second and no less significant, included an array of non-economic assets: expertise, practical knowledge and “most important an informal network assets accumulated during the preceding period. These processes released a set of boldly innovative, clique-based strategies aimed at converting non-economic assets into even more decisive control and ownership [...] Informal networks assets were powerful competitor of specialized skills and sheer power in term of their convertibility” (*ibid*: 368–369).

Stark and Bruszt (1998) in their book on the transformation of property in East Central Europe have also shown the crucial role social networks of members of the

5 In 2003 the Head of Multigroup was murdered .....(buscar ficha).

*Nomenklatura* (both political and technical) have had in the process of privatization. For these authors, network-type relations may also be construed as an alternative economic field of action different from markets and state.

Ganev commenting on the work of Stark and Bruszt accepts this assumption. However, he strongly rejects the assertion that inherited networks play a positive role in post-communism. For Ganev the problem of this position is that it rests on a one-sided and narrow understanding of network theory glorifying the positive aspects of the economic restructuring it can promote and not taking into account its negative results such as its exclusionary characteristics. Stark and Bruszt have denied that their real intention was to justify the predatory behavior of former apparatchiki and KGB operatives and refer to the double character of these social networks: “strong networks are a resource but they are not unproblematically so. They have the capacity to be agencies of development or rent-seekers depleting the public treasury and inhibiting economic growth”.

Although the discussion previously outlined is of outmost theoretical importance what is relevant to this paper is the importance and role that social networks have had in the process of privatization in post-communist societies and that issue seems to be accepted by both parties without any discussion.

In short, these examples in post-communists countries show how market opportunities were distributed also on the basis of networks of relatives, friends and comrades, who belonged to the political and technocratic *Nomenklatura* during the communist regime, becoming intermediaries that converted political capital into economic capital. According to Szelenyi (Eyal et al. 1998) it is through the “social and cultural capital”, including networks, knowledge, expertise, capacity to manipulate symbols that this *Nomenklatura* networks manage to turn public property into private wealth. Post-communism can best be described as a social space in which social and cultural capitals are the major sources of power and privilege.

The fact that personal informal networks (social assets, trust-based networks, contacts) are the basis of this important part of the economy means that trust plays a central role in the process of privatization and transition to post-communist societies. Trust is therefore the condition *sine qua non* that permits the configuration of the social networks responsible for the privatization. Ideally, however, when those informal cliques become formalized into conglomerates or enterprises the rule of law replaces the unwritten rules of trust.

### **Trust as a Survival Strategy**

Since the mid-1980s, the state welfare and protection systems have been shrinking and by now are far from being able to offer solutions for masses of people in trouble. The market is less and less an alternative for needy households because prices are increasing and their disposable incomes are decreasing. With the emergence of a market economy, some have become locked into permanent poverty. Thus, post-communism may have produced a “new poverty” which survives thanks to an informal economy based on the use of trust-based networks (Szelenyi 2001: 5–10). At the same time, the effects of price liberalization in 1992 hit particularly the previously

relatively well-to-do middle strata of Russian society. Suddenly such professionals as engineers, doctors and teachers found themselves at the brink of poverty. To cope with the new situation, different strategies were possible. One possible strategy was to enter the market economy by trying to increase one's revenue. But more traditional strategies were based on the use of personal relations, and hence, at least in principle, foreign to the abstract mechanisms of the market economy. First, social relations and brokers were used in order to be able to obtain rare products. Second, personal relations were needed in order to gain information about where to buy products or services. Finally, social relations could also help to get products or services more cheaply than through the formal channels (Lonkila 1997).

Lonkila in her study on *Informal Exchange Networks in Post-Soviet Russia* supports Ledeneva's conclusions about the continued importance of *blat* exchanges in post-communist Russia. She affirms that in spite of the institutional macro-level changes, which have affected the lives of individual Russian citizens, on the micro-level of Russian society many things have not changed. Informal exchange and patterns of behavior inherited from the socialist era still continue to influence the transition society in which the continuing lack of trust in official institutions and social services is compensated with the use of their personal relations. In the same way as the network economy operated to protect people from the rigidities of the Soviet system, today it protects both people and companies from the demands of the new "market" economy, by maintaining the flow of reciprocal exchanges in the economy, and the rise of corruption and barter. State, market and institutions of civil society have been influenced by informal practices not dissimilar to the Soviet case. The difference from the Soviet era, however, is that the unwritten rules of today's order are defined by the pressures of the global economy as well as by the internal context, which does not mean that the network economy has lost its importance (Ledeneva 1999: 1–2).

Amidst the turbulence of transition, what use do Russians make of their legacy of social-capital networks? In Rose's words and referring to Russia:

*In the Russian context, where modernization is problematic, it is first necessary to classify networks as pre-modern, modern, and anti-modern. Involvement in pre-modern networks is here indicated by generic reliance on informal networks to get things done, living in a village, trusting most people, regarding friends as a good source of information, and church attendance. Modern networks are here indicated by generic reliance on the market, belonging to a formal organization, turning to the government for help in dealing with a family problem, or being an opinion leader. Indicators of anti-modern networks are generic reliance on corruption or connections to get things done outside the rules, being excluded from involvement in all kinds of networks. Life in the Soviet Union socialized Russians into getting around laws and regulations through connections and blat, and the new Federation has created opportunities to get ahead. In consequence, anti-modern networks have become the primary source of income security or insecurity (Rose 2000: 42–43).*

## CONCLUSIONS

1. Trust is a cultural concept that should be ethnographically described, as its meaning varies according to the culture of each society and in every particular situation. In this paper, we present cases of three societies to show different meanings of trust and uses of trust-based social networks in each of them. Trust as a basic cultural trait has a longer life in the historical processes of society than their specific formal economic and political systems.

2. We discuss the importance of trust in the configuration of social networks, which allow an informal economy to emerge and flourish in complex societies. Informal exchanges based on trust are not only a residue of traditionalism but also an intrinsic element in many of today's complex modern societies.

3. Informal exchange networks develop within modern formal systems in accordance to the same rules of sociability determined by a particular culture; hence, the informal economic activities cannot be understood solely in terms of the laws of supply and demand or state regulations. On the basis of the three cases presented, an underdeveloped capitalist society, a centrally planned and in post-communism, we can appreciate how trust is culturally determined and evaluated, producing different degrees of contradictions between the formal ideology that guides the state and the cultural set of values that guides individual behavior. Ideological contradictions between formal and informal systems more often than not strengthen the rationale of friendship and kinship at the expense of official morality.

4. The degree of formality and the inability of the formal system to satisfy societal needs give rise to informal solutions. If the formal system were able to produce and distribute the goods and services required by all members of society, informal solutions would be less needed and thus less pervasive. Informal exchange networks allow large sectors of the population to survive, and maintain their status. However, informal activities also have negative consequences for society, as they do not increase the overall efficiency of the system; and tend to perpetuate inequities and facilitate corrupt exchanges, leading to the formation of criminal mafia-type organizations.

5. Depending on the formality of the system, the relative degree of "inappropriateness" (illegal versus just "not a nice thing to do"), the goal of the activity (profit-making versus altruistic), and the degree of repression, plus the extent of tolerance the society has toward breaking bureaucratic rules, modes of informal exchange may fluidly grade into: reciprocity, patron-client relations and market exchange. Given the growing importance of informal exchange in the formal sectors of modern societies, it follows that understanding the cultural rules governing kinship and friendship may be more essential than ever for gaining an insight into the operation of the economy and of the state.

6. In the cases studied, informal exchange permeated the formal system. If this fact is not always recognized, it is because of administrative sanctions and ideological conflict between the two systems. In Chile, the informal system was more an expression of sociability and class solidarity than a way of promoting business deals, large or small, therefore it was not recognized as a corrupt practice although there was a thin line between a-legality and illegality. In the Soviet Union, the prevalence of informal exchange depended, among other things, on the relative scarcity of the goods

and services available in society, and on the existence of tight controls. *Blat* was seen as part of sociability and social solidarity when it was not converted into market exchange. In post-communism, informal networks of the previous *Nomenklatura* elites, which possessed relevant knowledge, information and social capital were able to remove legal controls and create a “post-communist political capitalism”. In this case trust allowed the formation of networks whose aim was to “grab” the resources the communist state had been able to accumulate and convert it into formal enterprises from which they derived personal profits. In other words, post-communist societies in this transitional stage are witnessing the formalization of informality (of trust).

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