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Honesty and trust in the light of post-socialist transition

Establishing social trust in the period of post-socialist transition

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"Do you think most people can be trusted, or that you can never be cautious enough when dealing with other people?" researchers keep inquiring in questionnaire surveys. Do you believe that fair competition is going on for orders, public office holders and the officer round the corner cannot be bribed, politicians do pass decisions irrespective of their own and their parties' financial interests, investigative authorities do solve the majority of corruption cases, and courts of justice do enforce the law? Is it possible to succeed in an honest way, or is everyone – including you – forced from time to time to transgress the boundaries of everyday morality and law because these are the given circumstances, and everyone else, including politicians, business partners, friends and rivals, also does so? "Can the old folk wisdom saying 'a fish stinks from the head' be right?", one could ask at the end of 2006 with an even better reason than a few years earlier.

Those expecting answers to these questions, as well as a clear-cut picture of or at least unambiguous definitions and methodological approaches to evaluating the current situation in Hungary will face disappointment. Similarly to those that expect to read clear reasoning typical of János Kornai. The noted author undersigns this volume only as the editor and a co-author of the preface, given that this volume contains no writings by him. The book is a compilation of research papers produced by a research group intentionally not organised under "marked… and strict control", and it is not a "strictly structured publication constituting a coherent whole", but is a collection of studies[1] diverse both in terms of countries and disciplines, and relying on earlier investigations and "individual initiatives and ideas" (page 17) of 22 authors related to Collegium Budapest, and contains writings varied in terms of depth and substantiation.

In spite of this, or precisely due to this, no disappointment awaits those seeking thought-provoking hypotheses, writings arguing with one another overtly or covertly through approaches, and case studies often as exhilarating as crime stories from the borderlines of politology, economy, sociology and social psychology, law and anthropology.

WHY DO SWEDEN AND ROMANIA DIFFER?

A shared starting point of the authors is an assumption clearly put forward at multiple points in the book whereby the proper operation of the market as an institutionalised process is based on trust, i.e. belief in predictable and lawful conduct of business partners and state/political organisations without further sanctions applied or by way of enforceable legislation and rules. What could trust in our fellow humans and the authorities be rooted in, within that, is "the integrity of the government" a cause or an effect of this trust perceived as social capital? – this is what the first two studies polemicise about, immediately associating the central category of analysis with the degree of corruption.

Bo Rothstein's paper entitled "Social trust and the honesty of the government: the causal mechanism" states that the level of trust cannot be explained either by cultural heritage, or by the great weight and frequency of civil organisations alone. "The case may be simply that it is a certain type of political institution that generates social capital, and it is not social capital that causes the emergence of a certain (operational) political institution." (page 36) By comparing Scandinavian countries where trust is high and corruption is low with Romania where the situation is just the opposite, the author argues for a main source of social distrust being the corruption of authorities. His empirical examination shows that the highest level of trust is characteristic of groups that do not receive benefits or receive universal benefits only, while "personal experience gained with selective institutions checking the need undermines interpersonal trust". (page 45) Not assuming that Hungarian authorities and public office holders are less biased and corruptible than their Swedish counterparts, this may be a warning sign for all that argue for extending the more "fair" need-based principle instead of the benefits provided by virtue of civil privilege – provided the statement is true.

Eric M. Uslaner and *Gabriel Badescu*, however, instantly question the general validity of this thesis. "Honesty and trust are legal norms in the process of democratic transformation: according to their debate paper entitled "Why Bo Rothstein can explain Sweden better than Romania", "in Romania and in the countries where regime change took place, *the correlation between corruption and interpersonal trust is weak and inconsistent".* (page 56, italicised in the original) This correlation only works in line with the expectations in less corrupt countries. At the other end of the rainbow, however, people definitely separate large bribes from "petty" everyday corruption, considering the former as a playing field for the elite, which does not destroy their relationship with other people, quite the contrary, "…the higher the level of perceived corruption, the higher the proportion of citizens showing trust". (page 60) In such cases, remedy lies not as much in anti-corruption action but in moderating social inequalities, because the ratio of the former is one of the strongest predictors of trust.

PARADOXES IN TRANSITION ECONOMIES

The positive correlation between corruption and trust is not the only unusual phenomenon, paradox or dilemma seen in the studies. Not even the axiom "Trust is a blessing …Corruption is a curse" (page 50) is unquestionable. "As long as corruption persists, there is hope. Slush money!

The greatest chance of man. As long as judges accept money, there is a chance of justice." (page 56) Our eastern European socialization suggests that the well-known citation from *Brecht* is not mere irony; there is such a thing as "good" corruption that lubricates everyday administration and makes life liveable. However, there are downsides to personal and institutional mechanisms of trust building, and effects precisely opposite to goals. A form of protection against the uncertainty of the economic environment is to build out business networks based on personal relationships or reputation. What closed trust networks can do is not only represent price cartels (cf. *Radaiev:* "How is trust established in economic relationships, if both the institutions and the individuals are unreliable? The Russian case." pages 119–121) – i.e. causing damage to consumers –, but also limit the market options of the participants. In addition, networks may also serve the purpose of institutionalising corruption, ensuring permanent survival of its "embedded" form; accordingly, they precisely prevent the emergence of open markets, instead of facilitating it – this is how *Karen S. Cook, Eric R.W. Rice* and *Alexandra Gerbasi* summarise the statements of the literature ("Emergence of trust networks in uncertain times: the case of transitional economies as reflected by social psychological research"). Formal means, for example, contracts may even limit the development of trust, because these two approaches do not reinforce but replace each other – they argue. Using the cases of Russia and China, which follow basically different strategies, the author pair *Katharina Pistor* and *Chenggang Xu* shows in detail: "Paradoxically, the appearance of customary institutions and procedures of legal enforcement may conceal the fact that these, in the presence of incomplete law and information problems, precisely facilitate the spreading of corruption." ("What is beyond legal enforceability: control over financial markets in China and Russia", page 185)

For readers on close terms with institutional economy, which is frequently mentioned in this book, too, consideration of social history, path dependency and the socialization of individuals and institutions seems obvious. A solution to the "chicken and egg problem" also deserves further research: is it people's trust in one another that is primary, which then develops the appropriate state institutions and behaviour patterns, or, can the government generate trust from above?

The latter viewpoint means that the role of the state should be increased and not decreased at the time of a transition to market economy. Pistor and Xu also argue for this, relying on a comparison of the development of the Russian and Chinese stock exchanges: if the legal system is weak and reliable information is missing, the application of solutions going beyond legal enforcement and controlled by the government may be beneficial, such as the system of share quotas replacing competition among regions in China, and companies to be listed on the stock exchange selected by the authorities but in a decentralised way on a territorial basis. The authors present the downsides and the significance of built-in incentive systems, but they fail to provide comprehensive evidence of the efficiency of these – which would not be easy in theory, either, without knowing the end result of the unfinished process. Many experts would probably disagree with the extension of state interventionalism.

However, some of the authors in this volume believe that an important function of the state is to create the formal law and order, to enforce compliance with the law, and to propagate behaviour patterns and exemplary precedents. Trust shows the closest correlation with the assumption that courts of justice pass judgements fairly and honestly – *Martin Raiser, Alan Rousso* and *Franklin Steves* state ("Measuring trust in connection with the regime change: examination results of 26 transitional economies"). The various state organisations in the countries concerned, however, are not only weak but also corrupt themselves. A paradox of this situation is that for this reason – as established by Vadim Radaiev – "market actors do not trust state authorities. But they have still less trust in the institutions not backed by the state". (Ibid., page 121)

IN THE SHADOW OF A WEAK STATE: FROM FINANCIAL MACHINATIONS THROUGH CORPORATE RAIDS TO THE MOB

Radaiev's paper is one of the initiating analyses in the most voluminous and, for the reviewer, most interesting part of the book, accompanied by brilliant case studies about the operation of the post-socialist, chiefly Russian, business world. "How is trust established in economic relationships, if both the institutions and the individuals are unreliable?", the author asks. To his experience, the solution lies in releasing the formality of official rules. As a result, instead of trust, cautiousness is increasing in the fairly innovative Russian entrepreneurs, as well as preliminary checking on business partners, developing closed networks, extending new conventions and regular personal negotiations, and stigmatising the sinners. Then, considering that "no mutual or unilateral trust may develop without state interventions" (page 125), ultimately, certain consensus is also reached with public office holders. According to a relatively optimistic final conclusion, there is a path from personal trust at a micro level through mutual trust within networks to unilateral trust in institutions associated with such groups – if the state supports the institutions of market.

Not so optimistic are the other case studies, the majority of which describe the daily life of Russian economy using operating mechanisms generalised from interviews, press resources and actual company examples.

Examining the practical system viewed from an "ethnographic" aspect, *Alena V. Ledeneva's* paper entitled "The informal financial sector in Russia", considers the financial machinations utilising the back doors of regulation as essential methods for the participants to protect their property from corrupt authorities and from "the effects of distorted institutional frameworks" in general" (page 104). The study provides a view of the operating method of procedures used to organise the company's internal and external financial standing, using satellite enterprises to minimise tax, or transferring the consideration value of services, slush monies and payments for political purposes to the right destination using mediation services of dozens of seemingly independent foreign front companies through foreign funds transfers. We also get an insight into the series of contracts and letters of credit necessary to develop a barter transaction without using cash or loans, often aimed at capital flight, and into how the latter one can be carried out by founding local and offshore shell companies, or how businessmen use formal institutions and systems of rules for alternative (informal) enforcement, for example, the bankruptcy law to collect debt. A statement of the author that is worth accepting is that, considering that the point of these manoeuvres is to break the direct link between the company and its business activity, it is mainly these procedures and not the companies used as the instruments that are worth watching. And, the final conclusion is probably also true: "The existence of financial machinations …has started off a vicious circle: they offset the shortcomings of formal institutions, and 'assist' economic activity, but at the same time undermine formal institutions, and slow down the efficient operation thereof." (page 105)

One of these mechanisms, the selective utilisation of laws and state institutions is described through specific cases by *Vadim Volkov* ("Selective utilisation of state power in the

Russian economy: ownership disputes and corporate raids"). Starting from the late 1990s, open and hidden corporate raids – extreme and special forms of hostile take-overs – have proliferated in Russia, reaching an order of magnitude, according to the author, similar to the massive privatisation that took place in 1993–94. Internal buyout groups are replaced by external ones, principally under the effect of the new corporate and bankruptcy laws adopted in 1996–98, and use the authorities concerned as instruments. According to this template, the contender company institutes a bankruptcy procedure against the debtor, or – maybe without holding a single share – initiates protection of minority rights. After a fast and favourable court ruling, the company's management is replaced, then ownership change takes place, or simply the debts are collected and assets liquidated. This requires mobilisation of a network consisting of the following organisations: secret service or a consultancy company to obtain the details, to develop the scenario, an associated company to obtain the debts of the selected company, an appropriately influenced (local) court of justice, a paramilitary squad to enforce the ruling, a state criminal investigation organisation to perform further steps of coercive acts, and, finally, cooperative authorities. How then could the climax of such an action have been a couple of years ago? "The head of the security service… of Continental Management, Vyacheslav Trubnikov, formerly heading the armed forces of the Russian criminal investigation service in the rank of a lieutenant general requested the local directorate of the Ministry of the Interior to provide help to the squad to induct the new management. By this time, the factory and the surrounding part of town had been transformed into a fortress …barricades had been erected along the fences …The state of siege reminiscent of the best medieval traditions continued for another two weeks,…" (page 155) – but did not yield any success because, among others, the workers' community wrote a letter to *Putin*, and the president's personal intervention channelled the case back to the legal procedure.

If laws and state institutions are too weak to protect ownership rights, it is not surprising that private and half-private firms of former and actual state security and police officers start proliferating – Volkov states. These may have replaced the Mob in part, and this is why, as *Federico Varese* writes in his paper entitled "The relocation of the Mob", one of the most powerful groups, the *Solntsevo* crime syndicate tried to expand abroad. The Russian examples are illustrative evidence that the application method for regulators proven elsewhere – including the bankruptcy law, among others – are specified by the context, "a reality external to the legal system" (Volkov, pages 159–160). Concerning the Swedish example, Rothstein also states that good policies and institutions can hardly be copied. This, however, does not exclude exporting "bad ones", say, the Mob. Varese investigates the conditions of success, the offer from the Mob on the one hand, and – on the demand side – the level of trust and the protection level of markets. The Solntsevo did not manage to enter Italy in the second half of the 1990s, whereas it did Hungary, not only as a result of a different level of social trust but principally the weakness of the institutions of market economy, the absence of appropriate law and order and regulation of ownership rights, i.e. due to the existence of market segments left unprotected during the transition.

AND WHAT ABOUT HUNGARY?

Varese's study bears references to a number of facts and general statements known to Hungarian readers, among others the high proportion of informal economy, the uncertainties of corporate details and real estate registers, the augmentation of tax frauds, contract breaches and false bankruptcies. In addition, it is also disclosed that over one hundred murders and 170 explosions associated with the Mob took place in Hungary between 1991 and 1998, and approximately 800 companies were directly related to the underworld, and at that time, 80% of the interview subjects believed that breaking the law was necessary for succeeding. Due to the nature of the analysis, all these are only an illustration here, sourced from articles of daily newspapers, interviews and police statements, in addition to one or two studies.

In their methodologically well-substantiated social psychological analysis ("Blindness to success: social psychological hindrances on the road to a market economy in Eastern Europe"), the Hungarian authors published in this book, *György Csepeli, Antal Örkény, Mária Székely* and *Ildikó Barna* examine opinions on the background to success and wealth in developed and transitional societies. According to the recordings, people in Eastern Europe attribute success to external factors (the system of connections, initial advantages), and to a less extent to talent or hard work, compared to their western peers. In addition, during the five years following 1991, the blindness to success devaluing individual performance and suspicion about wealth, i.e. social envy was on the rise. Although, according to the initial assumption of the research team, "when looking at the transition from the aspect of belief in ideals such as justice, honesty and trust, people saw corruption, dishonesty, injustice and undeserved enrichment at points where in most cases nothing else went on but normal market operation" (page 230), this hypothesis remained finally untested. For that, one should know what reality is; but only a cognitive – or distorted – reflection of it is seen.

It seems as if the Hungarian social researchers – including the reviewer herself – would rather put down the stories about *Mogilevich* representing the Russian Mob or the bomb-maker *Clodo*, and only examine the formal or public sides of the processes that constitute the holy trinity of privatisation, liberalisation and deregulation. What do we really know about the operating mechanism of today's Hungarian capitalism? When we shudder reading the stories of corporate raids, do we consider at all that maybe it is not only the Mob that extend across the borders, but also that the manoeuvres, unlawful coercion procedures and methods of asset relocation ranging from fraudulent bankruptcies that hinder expansion of others through money laundering to provoking public administration actions and to the use of compromising materials described in detail in relation to the Russian economy are also operational in Hungary? Everyone remembers fragments of stories read in the newspapers (for a while), and could mention a few cases of corruption shared in private and even more assumptions and suspicions. But why are extensive investigative journalism, exploratory reports and empirical examinations that shed light on cases and operational models in detail missing in our country?

The issues of trust and honesty are not only about morality but also the crucial mechanisms of the society and the economy. To those interested, I recommend, in addition to the book presented here, the rich literature abundantly referenced in each of these papers. However, in order to learn more about Hungary, the basic analyses should be produced first.

Éva Voszka

Notes

[1] A counterpart of this book is *Building a Trustworthy State in Post-Socialist Transition* published in New York in 2004 also by Palgrave Macmillan.