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## **HONESTY AND TRUST IN THE LIGHT OF THE POST-SOCIALIST TRANSITION<sup>1</sup>**

### ***SOME IDEAS ARISING FROM THE 'HONESTY AND TRUST' RESEARCH AT COLLEGIUM BUDAPEST***

Honesty and trust—these are two subjects of interest and importance in all countries and all periods, although their importance and the challenge presented by studying them may be greater in the period of the post-socialist transition than elsewhere or at other times. That prompted Collegium Budapest, as an international, inter-disciplinary research institute, to initiate wide-ranging research into the subjects in the title.<sup>2</sup> Exponents of several subjects—economics, political science, sociology, jurisprudence, anthropology and political philosophy—came together from 17 different countries to exchange experiences and set down their ideas.

The intellectual background to this article is provided by the far-reaching research conducted under the auspices of Collegium Budapest.<sup>3</sup> I have taken over several ideas from the studies prepared there and refer in several places to the empirical experiences appearing in them. No less importantly, my thinking was also influenced fruitfully by the lively debates that went on in the research group. Nonetheless, the article cannot be considered as a summary of the research. We were not aiming in any case to arrive at common conclusions and we did not reach agreement on several issues. This piece of mine, as its subtitle indicates, presents nothing more than a few ideas of my own that were prompted by the Collegium Budapest project. They provide a taste that may encourage readers to approach the table, in other words, to gain a closer acquaintance with the studies that have been worked out in detail.

Let me warn readers in advance that this article concerns the countries of the post-socialist transition in general, not Hungary in particular, although most of what I have to say applies to this country as well.

The research covered hundreds of phenomena and relations. Only a fraction can be considered here. I confine myself to three problems: 1. relations between firms, 2. building a trustworthy state, and 3. the strategy for building trust.

#### ***Relations between firms***

Operation of the market rests upon private contracts between buyers and sellers. Students of microeconomics encounter in one of their first lessons the kind of contract between buyer and seller that assumes the seller will deliver the goods or services stipulated in the contract and the buyer pay the designated price. The contract may be drawn up in writing and acceptance of its terms certified by each side with a signature.

However, the contract still binds both sides if it was made only verbally or tacitly, i.e. by both sides to the transaction tacitly accepting the rules of a customary process of purchase and sale. The customers in a restaurant, for instance, do not sign contracts promising to pay the bill after the meal, but by sitting down at a table, they have made a tacit contract with the restaurant.

In reality, contracts of purchase and sale differ from the ideal in several ways.

There is no such thing as a *perfect contract*. Not even the most detailed contract can stipulate every detail, for complex agreements may have thousands of parameters. Furthermore, a contract lays down terms for the future, which cannot be predicted accurately with the best will in the world.

Along with a contract between a buyer and a seller, there has to be honest conduct by both sides. That is where trust comes in. When a contract is made, the buyer trusts the seller to observe its letter and spirit honestly, in the quality and delivery time of the goods or services. The seller, meanwhile, trusts the buyer to pay. The more honest the sides are, the deeper the trust between them and the lower the *transaction costs*.

Degree of trust can be gauged various ways, for instance in terms of the proportion of the price the seller requires the buyer to pay in advance. It is interesting to note that in Belarus, Ukraine and Russia, the proportion is about 40 per cent, while in Hungary, the Czech Republic or Poland it is about 10 per cent.<sup>4</sup>

Wherever there are private contracts between buyers and sellers, there are breaches of contract as well. A good measure of the honesty of the market (and society as a whole) is how frequent and serious such breaches are. Although there are no overall data available, it is commonly thought that such problems are more frequent and serious in the post-socialist region than in the mature, longstanding market economies. To some extent, the frequency and intensity of contract breaches can be a reflection of the trust and honesty prevalent on the market (and in society as a whole).<sup>5</sup>

The state has to enforce the observance of private contracts. There is a debate about what role the state should have in a modern, democratic market economy, but even a political philosophy that would reduce the state's role to a minimum cannot doubt that the state must enforce private contracts. This is a classic task for the minimal state. There can be said to be shortcomings everywhere in the way the state fulfils this task, and that the shortcomings during the post-socialist transition are especially grave.

Let us begin by noting that the laws themselves are imperfect. Just as it has been established that there is no perfect, watertight private contract, so it must be added that there is no *perfect law* either. It can be proved theoretically that legal loopholes remain even with the best will and greatest circumspection in the world. The less experienced and hasty legislators are (which was the case during the post-socialist transition), the further from perfect the law will be.

Parties taking breaches of contract to court find that the legal process is very slow. (It may be even slower in the post-socialist region than in mature democracies with more practised and efficient judiciaries.) What is worse, the courts may be biased or corruptible.

Finally, there are many problems with enforcing legal judgements. The bodies charged with enforcing them are weak and may be corrupt as well.

All in all, many who might expect the state to enforce private contract in full lack sufficient trust in the state. One participant in the research, Professor Vadim Radaev quoted a Russian survey.<sup>6</sup> Only 24 per cent of respondents stated that they would turn to the courts over a breach of contract.

How does a firm defend itself, if it lacks trust in the state and feels it cannot rely on the force of the law? Above all, it thinks twice about who it does business with

in the first place.

One obvious possibility is to confine business relations to *tried partners*, of which the firm has already gained favourable experience. This strengthens mutual trust, but it narrows the sphere of potential contracts of purchase and sale, which limits competition. So there are trade-off relations between trust and competition. The more trust becomes a criterion of choice, the more competition is curtailed.

Personal business relations can be augmented with further information, if a contracting party tries to check up on a partner in advance. A measure of reassurance may come from membership of a professional association or chamber of commerce, or trust may simply rest on what reputation the potential partner has in the business community. Those participating in the business world gain individual reputations, and it is right that they should. Professional and commercial opinion awards grades: 'This firm is honest, you can trust in it, but that firm is incorrect, dishonest and unreliable.'

This is apparent in the thinking behind the behaviour of tourists who arrive in a foreign city and want to rent a car. The market is dominated by large multinational firms. Although local firms may be offering better terms through their local connections, tourists have doubts about whether the unfamiliar firm will cheat them and tend to trust the multinational they already know.

Basing trust on name and reputation instead of weighing the specific terms of the contract reduces the chance of disappointment caused by breach of contract. But again, it curbs competition. The stronger and more effective the trust network, the harder market entry becomes. If it becomes essential to have a reference from a professional association, the association may turn into a guild or cartel and display anti-competitive behaviour. This is a further illustration of the same proposition of theoretical importance: there are trade-off relations between trust and competition.

Let us say someone has been insufficiently prudent (or lucky) in choosing a partner, who has breached the contract. Let us assume that the injured party is among those who never turn to the courts. What can he or she do? In most cases, people resign themselves to their loss. However, some decide to *take the law into their own hands*. For instance, they send round a few strong young men to the house of the businessman who has not paid his debt. In the survey quoted by Professor Radaev, 11 per cent of respondents said they would not shrink from violence to enforce a contract.

The term mafia is used quite widely in common Hungarian parlance, to cover almost all organized crime. In fact the mafia is a 'security organization', an illegal private police force protecting the interests of the businesses under its wing, even by force. One of its traditional functions is to collect money and debts. Some businesses request mafia protection, while others have the service thrust upon them. In either case, it is obvious that the mafia (in the original sense of the word) is satisfying a real need. It is enforcing private contract in places where official legal services cannot do so. The mafia becomes a strong force where the law is especially full of holes and the judiciary slow and corruptible, so that legal judgements are not enforced.

One young researcher, the Italian Federico Varese, had written a doctoral dissertation on the Russian mafia, and under the Collegium Budapest project, examined how one Russian mafia organization set about becoming multinational. It made its first attempt in Italy—not in the South, where the ground was taken, but in the North. It made sizeable legal investments, to gain standing as an honest business. Then it tried to build up a real mafia service. The experiment failed. In economists' parlance, the problem was with the demand, not the supply. Business in Northern Italy trusted in the force of law and the ability of the state to enforce private contracts. There was no demand for the mafia to meet.

It is a thought-provoking that the same Russian mafia managed to operate 'fruitfully' in Hungary, at least for several years, as police materials known to the researcher make clear. Unfortunately, there was a demand in this country for such enforcement of contract and security services.

Let me try to draw some more general conclusions from what has been said so far. Making and breaking a contract is not a lonely act by two isolated contracting parties. The environment in which the transaction is prepared and carried out involves three types of social mechanism:

1. *The legal-judicial-bureaucratic mechanism*: this enforces a private contract by state means.
2. *The moral-associative mechanism*: this rests on the honesty and mutual trust of the contracting parties. Honest behaviour enhances reputation. There are cooperative relations of partnership, not inimical relations between the two sides.
3. *The aggressive mechanism*: This rests on direct violence outside the law.

Two kinds of relation may develop among the three mechanisms.

The first combines mechanisms 1 and 2 into a *healthy complementary relation*. The two mechanisms reinforce each other. The more a business can trust in legal enforcement of private contract, the more rarely it will need to resort to judicial proceedings. 'I will sue you' becomes a *credible threat* and an effective one even if it is rarely applied. Business actors understand that dishonest behaviour is expensive, while honest behaviour is an investment that brings a return.

The greater the mutual trust between business partners, the fewer the court cases. That reduces the pressure on the judiciary and speeds up legal proceedings, which further reinforces the reputation of the legal-judicial-bureaucratic mechanism.

The second relation sets mechanisms 1 and 2 against mechanism 3. Here a *damaging substitution* develops. If the first two, legal mechanisms fail to operate properly, the vacuum is filled by the third, the illegal mechanism. The more the business world relies on mechanism 3 and resorts to illegal means, the lower the prestige of the law falls. The more the business actors fear each other, the less confidence in each other they have. The result is a vicious circle, in which damaging processes reinforce one another.

An important conclusion from what has been said can be found for social action. It is a misguided strategy to concentrate attention on combating crime, the mafia and criminality if the purpose is to clean up the business world. It is important and necessary to do so, of course, but that is not the supreme task. More important is to strengthen mechanisms 1 and 2, which in itself narrows the scope for mechanism 3.

### ***Building a state worth trusting***

The last section considered the relations of buyer and seller, in other words a *horizontal* relation, although the interactions described also involved the state. Let us now change subjects and place in the foreground the *vertical* relation between the state and the citizen. What is needed to strengthen confidence between the state and its citizens (or the state and organizations at the lowest level, such as firms)?

It is worth weighing a view advanced by Professor Russell Hardin, a distinguished American political theorist in the research group. Our starting point, he suggests, should not be trust, but what he calls *liberal distrust*.<sup>7</sup> Let us not squander our trust.

Think first of all of how *politicians* behave. I refrain from making any general condemnation. Many of them have noble intentions, serve the cause of humanity and

hold exalted ideas, or at least represent faithfully the interests of some stratum, group, area or constituency. But the noble intentions may be mixed with less noble ones: the pursuit of gaining or retaining power, maximizing votes, building a political and economic clientele, or simply increasing the earnings and wealth of themselves, their families and their friends. The combination of noble and ignoble aims differs from person to person, but the saintly ones motivated purely by altruism are rare indeed. Many politicians are incapable of judging objectively. They have bias built into them by their political philosophy and party loyalty.

Talking of the state, the other character that needs personifying is the bureaucrat. Again, let us refrain from generalizing. Many stand close to the ideal of a bureaucrat formulated by Max Weber, of a competent, upright public servant guided by professional conscience and the public interest. But the behaviour of many bureaucrats is not driven just by the public interest, but also by a desire to assert the interests of the bureaucracy (or a group within it). Bureaucrats are not usually indifferent to financial advantage and some cannot resist the temptations of corruption.

The institutions of the state and society need to be designed to take realistic account of the negative features of the behaviour of politicians and bureaucrats as well. Precisely because we are distrustful of the state and will inevitably remain so, we have to build requisite institutions to protect citizens and their organizations.

Of course the most important thing from this point of view is that representative democracy, Parliament, should operate efficiently, with political rivalry between parties supporting and opposing the government. The Collegium Budapest Project spent relatively little time on this, aware though we were of its fundamental importance.

The role of the judiciary, the other branch of power, was discussed in the previous section.

Several other instruments and institutions are available for protecting the interests of citizens. Without aiming at completeness at this point, I would like to draw attention to five institutions<sup>8</sup>

1. *Participation in drafting legislation.* Trust in the law is enhanced if the public feel they have taken part in preparing legislation, at least through their various spokespeople and representatives, but perhaps directly as well. Organization of such participation has either been neglected entirely in the post-socialist countries or done in a superficial, perfunctory fashion. The legislative choreography of socialism also included what were known as ‘social debates’, in which some important proposal or other was debated by ostensible representatives of special interests, i.e. the leaders delegated to run such organizations by the ruling party. Perhaps there has been some progress by comparison, but there has still been very little real debate or open, honest clash of interests and professional opinions.

There is no special law in the post-socialist countries governing participation in preparing legislation, which is entrusted to the voluntary initiative of the government and ministries of the day. There is no breach of the law if the process is omitted entirely. What is required is a law laying down the minimum effort to be made to enquire into the opinion of the public, designating the forms it must take, and making it obligatory to inform representatives of special interests and canvas their opinions.

Let me immediately add a caution. Assume that there will be such a law. Like all pieces of legislation, it will be full of holes. The administration will try to implement it either consistently and energetically, or only half-heartedly, for appearance’s sake. Nor is it certain whether the public will pay heed, or take the view that legislation is a matter for politicians and lawyers.

2. *Neutral, impartial institutions.*<sup>9</sup> Let me first give examples of the kind of institutions I am thinking of:

- o The Central Bank.
- o The banking system and perhaps some supervisory financial institutions.
- o The body supervising the stock exchange.
- o The state audit office.
- o The energy office.
- o The anti-monopoly organization defending commercial competition.

What do these institutions have in common? They are expected to remain outside the daily battles of domestic politics and in that sense too be neutral and impartial. They should take decisions solely on professional grounds. The integrity and expertise of their heads and staff should be a guarantee that they stand above politics and narrow professional and partial interests. It can be seen that these expectations resemble what is expected of the independent courts of law. The six institutions listed are only examples. The total number is much greater. They are concerned with state regulation and/or supervision not only of the state or the economy, but of other spheres as well.

Whichever institution in the category is scrutinized, a range of problems appears in meeting the expectations. They begin with the selection and appointment of heads for the neutral and impartial institutions. They are not selected by Providence. Someone (perhaps the prime minister, the speaker of Parliament or the president) has the power to submit the nomination for the appointment. Some other person or persons have the right to examine the candidate for suitability and confirm the proposal. Finally, someone has the right to sign the document of appointment. This means there cannot be complete independence even at the appointment stage. The head of the neutral institution will probably be an advocate of one political philosophy or another and may indeed remain loyal to the political force or personality that gave him his function.

One requirement for trust is accountability. This is not provided for in many cases, or left as an empty formality. The link between the assignment of responsibility and the performance of it is broken. On the one hand, the impartiality and independence are helped if the head of such an institution is appointed for quite a long term (perhaps for life). On the other hand, this has its drawbacks: the accountability dwindles further and there is no way of dismissing a head who performs weakly.

We are faced with the contradiction inherent in a democratic organization of state. One essential guarantee of democracy is a multiparty system, party rivalry, and dependence of the government on a majority in Parliament. On the other hand, the aspiration is to instil in citizens trust in those performing some functions of state by reassuring them that these are experts who will operate independently of parties, domestic politics and Parliament. Trust in representative democracy is to be strengthened by handing important decisions over to unelected officials. We are faced with a contradiction that has not even been clarified theoretically.

3. *Referenda.* It is not surprising that the idea of applying the institution of direct democracy widely was advocated mainly by the Swiss member of the research group, Professor Bruno Frey.<sup>10</sup> He drew attention to a number of advantages.

In a parliamentary or local election, the electorate is voting for a party or a candidate. That means choosing a 'package', as the party or candidate represents specific opinions on a range of issues. An elector may not agree with the party or candidate chosen on a number of these, but still vote that way out of sympathy for the political philosophy and record represented or out of agreement on most of the issues. The voter has bought an agreeable 'package', some parts of which he or she would

have preferred to throw out. Referenda, on the other hand, allow citizens to vote on a clearly circumscribed issue, not a 'package'. This encourages more specific, professional, constructive thinking and a greater sense of civic responsibility. State action initiated in this way inspires deeper trust from citizens.

Referenda can be called not only on matters of national concern, but on questions applicable only to a smaller administrative area, a town or a village. That provides further chances for decentralizing decision-making.

In the knowledge of all these arguments in favour of referenda, it is necessary again to add a caution. It is not the case that the referendum as an institution can avoid the customary channels of domestic politics. In many cases, the referendum is initiated, explicitly or tacitly, by political parties or other organized political forces, and the same forces may influence or even manipulate the voters.

Certainly, Professor Frey's warning is justified—there is no jumping into direct democracy. The public has to learn how to live with it. The practice of putting greater or lesser state or legislative matters before the electorate in referenda has to be introduced gradually.

4. *Non-governmental organizations (NGOs)*. An important trust-building role can be played by various non-governmental organizations and voluntary, civil associations.

Several times in the debates, mention was made of the now classic work by Robert Putnam on the democratic institutions of North Italy.<sup>11</sup> Putnam produces data to show a close positive correlation between the number and activity of NGOs and civil associations on the one hand and mutual trust among members of society on the other. This mutual trust creates 'social capital'.<sup>12</sup> The more actively citizens are in contact with each other and the greater the number of associations and NGOs citizens in which the contact occurs, the greater becomes the 'social capital'.

Putnam's trailblazing work involved several empirical surveys. Some of these backed his original hypothesis, but there was counter-evidence as well. There are indeed organizations that rise above political divisions, but on the other hand, there are many that are under the open or secret political influence of some political force or were instigated by it. The more divided are society's various dimensions (for instance, in political stance or ethnic or religious affiliation), the more suspicious the organizations of 'civil society' become towards each other.

5. *International organizations*. The European Union is of course the most important international organization for the countries that will shortly become members or aspire to do so. Others with very important roles are the international financial institutions—the International Monetary Fund (IMF) and the World Bank—the World Health Organization (WHO), the International Labour Organization, and other UN agencies.

It reassures citizens to know that intervention by international organizations may offer some protection against abuses and omissions by the national government or domestic politicians and bureaucrats. There was a recent example with the SARS epidemic, when strong intervention by the WHO was needed before China finally admitted the problem and took adequate measures. The IMF, on more than one occasion, has defended the long-term economic interests of a post-socialist country against populist spending and mistaken policies by its national government.

A caution again: experience shows that no international organization is infallible. Quite often, the intervention can do more harm than good. And even if the international organization's position is correct, it is not necessarily capable of asserting against the resistance of the national government and bureaucracy concerned.

I would like to end these comments with a general observation. Each of the five points has ended with a warning, like a refrain: yes, the institution concerned can play a very useful role, but its influence is limited and problematic, and may even backfire. People may abuse the rights and authority of any institution. Even the best-

designed and best-organized institution can be outwitted. This idea is worth taking further, into the realm of theories in social sciences. I would like to add a few remarks from my own discipline, economics. For a long time, it sounded almost pejorative to refer to someone as an ‘institutional economist’. It meant that the person was not up to doing real analysis of economic phenomena, designing a model, or using it to help draw conclusions, but only to describing verbally the institutions of the economy.

A few years ago, the situation changed. Perhaps the turning point can be associated with Douglass North’s Nobel Prize,<sup>13</sup> which appreciated demonstratively the scientific importance of institutionalism. Since then, this approach has received new impetus and become positively fashionable, as happens in many similar situations. Then came a period of exaggeration, when a correct, previously often-used approach was taken to extremes. Whatever problem was encountered, the answer was at hand: it arose because the institutions were not suitable, and the solution was to build up suitable institutions. The economists’ profession can certainly be said to have gone to that extreme, but other social sciences have exhibited similar symptoms.

The first two sections emphasized how important institutions are. It is essential to organize consciously an institution suitable for the task at hand and/or to allow it and encourage it to grow spontaneously. But advantage can be taken of even the best-looking institutions. I do not want here to give a methodical account of what other factors can contribute to this, simply to single out one factor: *a weak character at the head of the institution*. Whatever the law may prescribe for an ostensibly neutral, impartial institution, it will prove to be illusory if the head of the institution is servile, either towards the government of the day, or towards any other political force. It is fruitless for the institution to rest on the assumption that its head has to personify expertise, objectivity and moral integrity if he or she is actually incompetent, partial, biased and even corrupt.

The post-socialist countries have good chances of putting in place the legislation and other regulations that characterize a market economy based on modern democracy and private property. That is a necessary, but not a sufficient condition for trusting in the state. How do the mechanisms for selecting leaders operate? Who are the people personally responsible for the operation of the institutions? Are they suitable for their tasks? Are people suitable for the new tasks being trained to fulfil them?

### ***The strategy for building trust***

The questions put at the end of the last section lead to the third subject I set for this article. What should the strategy for building trust be? Are there ‘essential tasks’ whose energetic pursuit will at once give a big boost to the whole process? Or to use an old Leninist formula, are there ‘decisive links’ in the chain of tasks?

According to the Swedish member of the research group, the political scientist Bo Rothstein, the most important task is to make the state bureaucracy honest, expert and incorruptible.<sup>14</sup> The public in Sweden considers its state bureaucracy to be expert and honest, and this has an exemplary effect, spreading to the business world and other spheres of social activity.

Eric Uslaner, an American member of the research group who contributed a study with a Romanian co-author, supported in the debate and in an earlier book the view that the essential question is upbringing.<sup>15</sup> The members of society have to be socialized in a way that imbues their behaviour with the norms of honesty.

A campaign against corruption and misuse of public funds has become the centre of attention in Hungary, not as a declared programme, but in the practice of public life. Meanwhile many other aspects of honesty and trust are forgotten in parliamentary debates, on television and in the press. There is hardly any mention of how one businessman cheats another, sellers cheat buyers, builders future house-owners, and debtors their creditors. Hardly anyone (except in the stormy aftermath of some exceptional event) enquires into the professional standards and impartiality of the so-called neutral, objective institutions.

The research group at Collegium Budapest did not reach a consensus on what has to be done. That was not even considered the task. If the government or Parliament appoints a committee of enquiry into a matter, the committee is expected, as the outcome of its work, to make practical recommendations that the committee itself—after some internal concessions and compromises—accepts these and puts them forward as its own proposal. Our group did not constitute such a committee. We are researchers into a fascinating subject, whose prime task is to present the problem clearly, identify the factors causing the trouble, and delve as deeply as possible into the associated relations of cause and effect. Some of us arrived as far as making practical proposals, while others stopped at the stage of analysing the problem. There were some recommendations that everyone, or almost everyone agreed with, and others that aroused lively debate within the group—and that is as it should be.

I take the view that there are no ‘essential tasks’ or ‘decisive links’ and there is no point in looking for them. We are faced with a highly complex cluster of tasks. Some 10–15 have already been mentioned in this short piece, all of them very important. As I emphasized in the introduction, this article discusses only a fragment of the great, comprehensive subject of honesty and trust.

Whichever part of the overall subject is carefully examined, some important tasks immediately emerge. If these are neglected, this is where the abuses will appear, this is where mutual trust will be precluded. There is no way of launching a sudden attack. In this campaign, the attack has to be on *every front* all the time.

One important starting point when the strategy is being planned is to consider that although these are phenomena found all over the world, we happen to live in a specific zone, in the societies undergoing post-socialist transition. Many problems, including the ones touched upon here, appear indiscriminately in every country. Nonetheless, the course of history up to the present situation has much to do with how the solution is approached. That is the oft-mentioned phenomenon of ‘path dependence’. Even if two countries appear to be in a very similar position, they reached it by different historical paths. However obvious this attitude may be, for instance, to a historian, it is often quite forgotten by those who recommend adopting mechanically well-tried institutions, regulations and forms of organization from abroad.

I would place the tasks awaiting the post-socialist countries in two groups, according to required speed of fulfilment and the conditions inherited from the past.

To the *first group* belong the *legislative, judicial and institutional tasks*. They concern building a state of law in conformity with political democracy and a market economy with dominant private ownership. This will ensure that the trust of economic actors will be reinforced, citizens protected from officialdom, and the state worthier of its citizens’ trust.

What legacy did socialism leave in this respect? There is no question of any revolutionary, extra-legal state pertaining under the consolidated socialist system. On the contrary, every action is subordinated to millions of regulations and state instructions. This dense fabric was not torn aside by a few bold strokes of the sword in 1989–90. There were exceptional events in some countries (such as Romania), but the

region as a whole was noticeable for the *peacefulness* of the transition. The fabric of legal order was unravelled and rewoven piece by piece, in many tiny details. This is a less conspicuous process, but a more effective and forbearing one. All the inherited regulations were retained until they were set aside individually. Some of the earlier laws had to be thoroughly revised or replaced by new ones. Many new laws had to be passed to regulate actions and relations that had not existed under socialism.

Martin Raiser, a senior staff member of the European Bank on the research team, provided statistics to support the assertions that the more advanced institutional and legal reform is, the better the administration works, and the worthier the operation of the courts of law are rated, the stronger the mutual trust between business partners.

The building of a state of law can reach a stage where the task has largely been accomplished. In that sense, a post-socialist country may have caught up with countries where an up-to-date, democratic state of law has been in place and developed uninterrupted, without any socialist detour of several decades. Several countries in the post-socialist region can be said to have reached that stage, including Hungary, Poland, the Czech Republic, Slovenia and the Baltic states. Other countries obviously remain far from mature, democratic constitutional statehood, having covered, perhaps, only half of the course. That applies to most Soviet successor states, especially in the western and southern zones. But even in their case, it can be clearly defined which legislative and institution-building tasks can and must be accomplished in the foreseeable future.

That, of course, will not end the process conclusively. There will be a continuing need to improve existing laws and keep developing institutions. New legislative and institutional assignments are being set by the development of science and technology, shifts in the population, transformations taking place in the outside world, and many other changes. *In that sense*, the task is endless. Nonetheless, it can be sensed from what has been said that most of the work has to be done at the beginning of the post-socialist transition. The task cannot be accomplished by shock therapy or in haste. It has to advance gradually, over several years. The period it requires is not long by historical standards, however. It does not take more than a decade or two. Once it is more or less done and the big investment of time and energy has been made, there remains only the 'maintenance' and 'renovation' of the state of law.

The *second group* faces different tasks. Many could be listed here, but all can be said to concern people's *mentality*.

The dynamics of the tasks resemble those of the first group insofar as the legacy of the past has to be overcome initially. A curious combination of trust and suspicion developed in people under the communist system. I will trust a friend, but I do not know whether someone who does not belong among my closest friends is an informer or not. I am immediately suspicious of any organization of the party-state, whether it is the police, the tax authorities or the local council.

People are joined by a great many networks of trust. If something is in short supply, people expect to receive it through another member of such a network, rather than through honest business relations at a fair price.

Cheating the state is nothing to be ashamed of and does not count as dishonest conduct. On the contrary, it is a political act of civil courage, practised by adults and even taught to children.

And then came 1989–90. How could such deeply embedded habits be expected to vanish easily?

I was listening to a phone-in broadcast in the mid-1990s, where the presenter asked listeners to give examples of how they had managed to outwit the customs on returning from holiday spent abroad. They were to tell us their most exciting adventures. People were ringing in one after the other, boasting of having broken the

regulations and cheated the state. I have no illusion, of course, that such cases occur even in the most law-abiding countries. The main difference is not the frequency of customs fraud, but the social acceptability of it. A radio presenter in the United States or Norway could not put such a question and those defrauding the customs would not boast about it. There is tax evasion everywhere, but people are ashamed of it in mature democracies. They do not brag about it at social gatherings.

The post-socialist transition brought moral confusion. The old moral principles live on in the minds of many people, while others are influenced by the old and the new at once, though they are actually incompatible. Let me give one example. People are often at a loss to know what to think of how other people's earnings and wealth have increased. One member of the research team, Antal Örkény and his co-authors did noteworthy research into this in Eastern Europe and several other countries.<sup>16</sup> Respondents were asked what factors explained the enrichment of others. Several possible factors were offered in each case, such as hard work, connections and dishonesty. Nowhere did respondents rule any factor out, but in Eastern Europe, a much larger proportion of respondents saw private connections, and more sadly still, dishonesty as the source of wealth. There is no way of telling what the true proportions are. However, it is strongly characteristic of people's mentality here that they should have this *perception*. Many people cannot come to terms with the idea of people managing to earn a lot of money honestly, although this is a salient feature of the capitalist system.

What I said to the working group on legislation and institution-building was that the bulk of the work can be completed in a decade or two. But the reshaping of people's mentality cannot be expected to be more or less over so soon. The speed of the process varies strongly, depending on the individual's disposition. With some it will go faster and with some slower. Furthermore, *within* an individual's intellectual and emotional world, there will be some aspects that change faster and some that change slower. In fact, the process will really start to speed up only when we, the older generation, hand over to the younger people, to the ones who have been socialized in a different way and developed their moral norms and behavioural reflexes under different influences.

This does not mean that the change can simply be left to time, while people watch passively as dishonesty and oppressive uncertainty spread around them. The tasks begin with upbringing and education—in families, schools and universities. Untold good (and damage) can be done by the press and television. The approach citizens take is shaped by the words and deeds of every public figure and workplace manager.

This is an unending task. I wish myself and every member of post-socialist society the patience and endurance it requires.

## **Notes**

<sup>1</sup> This discussion paper translates a revised version of an article in Hungarian (Kornai, János, 2003. Tisztesség és bizalom a poszt-szocialista átmenet fényében. *Beszélő* 8, pp. 20–29. and *Rubicon*, Summer, 2003). The author expresses thanks to Brian McLean for his careful translation and to Susan Rose-Ackerman and Bo Rothstein for their valuable advice.

- <sup>2</sup> The research was headed by the author and Professor Susan Rose-Ackerman (Yale University, Law School). Details of participants, general objectives, organizational framework and conferences to discuss papers, along with some research findings, appear on the website : [www.colbud.hu/honesty-trust](http://www.colbud.hu/honesty-trust). A selection of the papers will be published in English in two volumes by Palgrave Macmillan in the spring of 2004:  
*Building a Trustworthy State in Post-Socialist Transition* Eds.: János Kornai and Susan Rose-Ackerman. Palgrave Macmillan, New York, 2004.  
*Creating Social Trust in Post-Socialist Transition* Eds.: János Kornai, Bo Rothstein, and Susan Rose-Ackerman. Palgrave Macmillan, New York, 2004.  
 There is a vast international literature on the subject. I can recommend as an introductory overview two 2001 studies by Susan Rose-Ackerman: Trust and Honesty in Post-Socialist Societies. *Kyklos* 54, pp. 415–43.; and Trust, Honesty and Corruption: Reflections on the State-Building Process. *Archives of European Sociology* 42, pp. 526–70.
- <sup>3</sup> I first lectured on the subject in the title on April 5, 2003, at a conference for history teachers organized by the editors of the Hungarian periodicals *Beszélő* and *Rubicon*, entitled *European Union: Community of Interest and Values*. That oral lecture has provided the basis for this article. In expressing it, I have not sought to convert it into a strict academic paper, trying instead to retain the style of the spoken word.
- <sup>4</sup> See Raiser, Martin, Alan Rousso and Franklin Stein. 2003. *Firms trust? Evidence from a survey of 26 transition economies*. Collegium Budapest. Most studies cited here are discussion papers produced under the Collegium Budapest (hereafter CBp) Honesty and Trust Project. It is not yet possible to cite printed publications. Customary bibliographical details are given only for works that have *not* been prepared as part of the Collegium research.
- <sup>5</sup> The relation is not a mechanical one. If dishonesty has reigned, people are reluctant to conclude contracts and so breach of contract will be rarer. If the justice system is rapid and reliable, business will be more inclined to conclude contracts with unknown partners, which will in turn raise the number of contract violations.
- <sup>6</sup> Radaev, Vadim. 2003. *How trust is established in economic relationships when institutions and individuals are not trustworthy (the case of Russia)*. CBp. See also the study by Woodruff, Christopher. 2003. *Establishing confidence in business partners: courts, networks, and relationships as pillars of support*. CBp.
- <sup>7</sup> See Hardin, Russell. 2001. Liberal distrust. *European Review* 1, pp. 73-89.
- <sup>8</sup> For the ideas discussed here, I rely mainly on the study of Rose-Ackerman, Susan. 2003. *Public participation and government accountability in consolidating democracies: Hungary and Poland*. CBp.
- <sup>9</sup> See Rose-Ackerman. 2003; and Sajó, András. 2003. *Neutral institutions*. CBp.
- <sup>10</sup> See Frey, Bruno. 2003. *Direct democracy for transition countries*. CBp.
- <sup>11</sup> Putnam, Robert D.: *Making democracy work: civic traditions in modern Italy*. Princeton: Princeton UP, 1993.
- <sup>12</sup> The concept of ‘social capital’ was explained by Putnam in a later work: ‘Whereas physical capital refers to physical objects and human capital refers to the properties of individuals, social capital refers to connections among individuals—social networks and the norms of reciprocity and trustworthiness that arise from them. In that sense social capital is closely related to what some have called “civic virtue.” The difference is that “social capital” calls attention to the fact that civic virtue is most powerful when embedded in a sense network of reciprocal social relations. A society of many virtuous but isolated individuals is not necessarily rich in social

- capital” (Putnam, Robert D. 2000. *Bowling Alone: The Collapse and Revival of American Community*. New York: Simon and Schuster, p. 19.)
- <sup>13</sup> The most influential works by Douglass North are his 1981 *Structure and Change in Economic History*. New York: W.W. Norton, and his 1990 *Institutions, Institutional Change and Economic Performance*. New York and Melbourne: Cambridge UP. North received the Nobel Prize in 1993.
- <sup>14</sup> Rothstein, Bo. 2003. *Social capital and the quality of government: the causal mechanism*. CBp.
- <sup>15</sup> Uslaner, Eric, and Gabriel Badescu. 2003. *Honesty, trust, and legal norms in the transition to democracy*. CBp; and Uslaner, Eric. 2002. *The moral foundation of trust*. New York: Cambridge UP.
- <sup>16</sup> Örkény, Antal, György Csepeli, Mária Székelyi and Ildikó Barna. 2003. *Blindness to success; social psychological objectives on the way to the market economy in Eastern and Central Europe*. CBp.