Informal Exchange Networks in Formal Systems:  
A Theoretical Model*

Larissa Adler Lomnitz

Studies of the informal economy in the Third World have evolved toward defining the informal sector in relationship to the state. This article analyzes some activities that escape the control of the state, with special attention to centrally planned economies. Informal exchanges include bureaucratic favors (“connections”), clientalism, different forms of corruption, and the “Parallel” system of production and marketing. I show that economic laws are not sufficient to understand the logic of these economies.

Most of the literature on the informal sector has concentrated on the urban poor and more generally on social categories that are excluded to some degree from access to services provided by the modern state. Networks of reciprocity and patron-client relations have been shown to play an important role within these disadvantaged sectors, in articulating their members to the formal market system and in creating an informal social security system to survive (Lomnitz 1977, 1978, 19821).

The present article proposes to examine a different aspect of “informality”: the pervasive utilization of informal modes of exchange within the formal sector itself. These exchanges include various forms of trading influence and bureaucratic favors for equivalent services or cash. Depending on the political system, some forms of informal exchange may be tolerated while others may be severely repressed. Even in the latter case, however, illicit economic activities (“economic crimes”) in the state bureaucracy are often seen as inevitable (if not actually useful) by members of elite groups within the formal system. I show that these activities are not random or chaotic but are based on informal networks following principles similar to those in shantytown networks: patronage, loyalty, and confianza (trust). Often the networks run underneath and parallel to the formal hierarchy.

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. Political science and anthropology, however, based on first-hand observations in underdeveloped, non-Western societies, have developed an extensive literature focusing on the discrepancies between the goals and structures of organizations and the historical and cultural specifics 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 (arising from inefficiency). Personal culturally determined loyalties to kin and local groups

* Most of this study was done while I was enjoying a Martin Fellowship at the Truman Institute of the Hebrew University. I also thank Professor Cinna Lomnitz for the English version and Ms. Elsa Blum for her assistance in editing the last draft of the paper.

Cohen (1980: 75–78) has also described how overcentralized decision making has produced a proliferation of hierarchical levels and consequently of corruptive practices within the Nigerian state apparatus.
often defy the more nationalistic ideologies that underlie bureaucratic rationality. (For a review of this literature, see Britain and Cohen 1980; Scott 1972.)

This article is generally in line with the literature mentioned above, but goes a step further in that it sees “informality” not only as a residue of traditionalism, but as an intrinsic element of “formality” insofar as it is a response to the inadequacies of formalization. It is an adaptive mechanism that, simultaneously and in a vicious cycle, reinforces the shortcomings of the formal system. Modern industrial societies do not escape “informality.” A clear example of this is the Prohibition laws in the United States, which brought about a number of informal mechanisms through which society fulfilled its demand for liquor. Those informal activities disappeared with the end of Prohibition (for types of corruption in the United States bureaucracy, see Rose-Ackerman 1978:216-234).

This article reviews three cases that exemplify different types of state control: pre-1970 Chile, in which the state’s role was that of regulating and distributing social services; Mexico, where the state apparatus not only regulates and distributes social services, but also controls a great percentage of the economic activity through state enterprises; and the Soviet Union, where production and distribution of all goods and services are under state control.

The main points of this article are as follows:
1. The more a social system is bureaucratically formalized, regulated, planned, and yet unable to fully satisfy social requirements, the more it tends to create informal mechanisms that escape the control of the system.
2. Informal modes of exchange grow in the interstices of the formal system, thrive on its inefficiencies, and tend to perpetuate them by compensating for shortcomings and by generating factions and interest groups within the system.
3. Informal activities are socially embedded transactions that obey a symbolic-cultural logic that differs from (and often clashes with) economic rationality or the formal ideology of the state. The rules of sociability that govern informal exchange vary from culture to culture.
4. 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 exchange may fluidly grade into each other: patron-client relations could be based on reciprocity networks and/or generate 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.

Reciprocity: The Roots of Informality

Informal exchange of services and goods within a formal social system develops in response to scarcity. Informal exchange tends to deal with commodities that are not freely available in the formal systems: rationed or restricted goods, access to decision makers, influence on administrative decisions, or more generally preferential treatment at the hands of the modern bureaucracies.

For example, in a study done in Chile among the middle class. I found the existence of a system of reciprocity that involved a continuing exchange of complimentary services (“favors”) motivated within an ideology of kinship and friendship (Lomnitz 1971:93106). Essentially, this system is egalitarian in that it presupposes that all members of the urban middle
class may have access to social connections within the civil service hierarchy—“anybody has friends and relatives.”

Favors dispensed to friends or relatives within such a system include job placement loans by government agencies; preference in legal matters; waivers of priorities; and miscellaneous bureaucratic favoritism in obtaining licenses, certificates, transcripts of documents, passports, permits, identity cards, tax clearances, and countless other items, including social introductions to people who can eventually procure these favors.

Services of this kind, when performed by social equals, were rendered without 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” (Lomnitz 1971:94). Thus, the rules of sociability prevent the partners of the exchange from making the requirement of reciprocity explicit. Yet the requirement exists: it is a debt of honor that may be payable at any time (though again the earlier favor is not mentioned). Other restrictions exclude requests for reciprocity in cash or in sexual favors (though borrowing small sums of money is common among close friends).

Material payment in return for favors is graft. It means the absence of a 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. Thus compliance with the unwritten rules of reciprocal exchange of favors is important because it is the hallmark of middle-class status. The major resource of the middle class is the control of public and private administration, thus the system of reciprocal exchange of favors amounts to a system of mutual solidarity essential to the survival of the networks that comprise the middle class.

Figure I represents the continuum of social distance as perceived by a Chilean from the middle class. Labels such as “intimate friends,” “close friends,” “acquaintances,” and so on are categories used by ego to classify relations. Individuals may move 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. It can be said that the practice of reciprocity is embedded in an ongoing social relationship and is determined, to a great extent, by “intervals of sociability” (Sahlins 1963: 144).

The importance of reciprocity in the informal economy is that it presupposes between the partners of the exchange a special kind of psychosocial closeness, which in Spanish is called confianza (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 who 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.

Conflicts of Interest: The Dynamics of Informality

Reciprocity networks exemplify the kind of sociocultural structures that have generated the modern systems of informal exchange within the formal sector. 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 case of the Chilean middle class, 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,” and family, and group solidarity. In Mexico, for example, where there is a strong familistic ideology that overrides the European liberalism of the 20th century, members of the urban middle class and of the state apparatus also tend to feel less guilty about complying with the requirements of the informal system than their Chilean counterparts (see Cohen [1980; 78-80] for a discussion of value conflicts in Africa, or Rose-Ackerman on the moral costs of being corrupt in the United States bureaucracy 1978:13, 228–234).

The conflict between rival ideologies is expressed in the rules of exchange. In the case of the study of Chilean reciprocity networks, we might say that in most Latin American countries these rules, 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 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.

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; hence, 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.

Readers will have no difficulty in supplying more examples from their own societies (see Scott 1972; Cohen 1980), because informal exchange permeates the formal system everywhere. If this fact is not always recognized, it is because of administrative sanctions and ideological conflict between the two systems. In pre-1970 Chile, the informal system was more an expression of sociability and class solidarity than a way of promoting business deals, large or small. Other societies (e.g., Mexico or the Soviet Union) may draw other distinctions. The prevalence of informal exchange will depend, among other things, on the relative scarcity of the goods and services exchanged, and on the strength of the controls and cultural inhibitions in the formal system.

Thus, in the United States recourse to informal exchange may not be necessary in the case of telephone connections or access to schools because these services are available to paying subscribers in abundance. On the other hand, informal exchanges, variously known as “horse-trading,” “lobbying,” “influence peddling,” or simply “kickbacks,” have always existed in the United States when the rewards are high enough, despite the Protestant ethic and other controls.
The effect on the formal system may be considerable. When there are scarcities of long-standing, the informal system is widely tolerated, despite continuing ideological conflict (expressed through moral objections), and becomes an expression of class solidarity. The point is, of course, that reciprocity of favors does not increase the overall efficiency of the bureaucracy; rather, it tends to perpetuate inequities and lags in supply by encouraging people to “jump the queue.” Often, it is difficult to decide whether informal economic activities are a result or a cause of scarcity.

Another important point is the moral effect of the informal system on the bureaucracy itself. In the case of Chile, for example, far from being demoralizing, compliance with the rules of sociability that surround reciprocal relations, 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.

**Secularization of Reciprocity**

The preceding discussion is intended to show that the social context of informal exchange introduces ideological components and that these components lend an almost “sacred” character to the performance of the obligations derived from the exchange. We are dealing with basic symbolic structures as related to primary solidarity. When reciprocity is bereft of its social context, there is a secularization of the institution of reciprocal exchange and its gradual transformation into market exchange.

Market exchange arises when (1) a personal relationship between the partners is precluded because of class differences, (2) the state apparatus increases in size to an extent that makes it increasingly difficult for 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 the private business class of urban Chile, certain favors such as customs clearance or business licenses were obtained through bribes, 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. In Mexico, to avoid possible embarrassment, such informal market exchange is usually conducted through intermediaries called coyotes. In this fashion, both partners of the exchange are spared the need to acknowledge their participation in terms of a personal confrontation.

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. But 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 charging the client an added “tax” or other nonexistent service charge. Highly placed officials may employ a lawyer who puts the “bite” on applicants, or they may hire a law firm to do so.

This is not to say that all bureaucratic favors are settled through bribes. An individual official has, in addition, a network of personal contacts where reciprocity is so rich and so pervasive that it constitutes a network of horizontal and vertical exchange relations that parallels the formal hierarchy (Lomnitz 1982). 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 reciprocal exchange has no such negative aura and is certainly more uninhibited than in Chile.

In general, moral standards are culturally conditioned and vary with each society. In the corporate state system of Mexico, the hierarchy of rank tends to overrule class solidarity; hence the prevalence of patron-client relations over reciprocity relations between social equals in the bureaucracy. This does not preclude the case of exchange partners making private deals or otherwise using their administrative positions for personal profit. The onus on such operations is the same as in Chile, but the shade” zone between the formal and the informal systems is larger.

**Patron-Client Relations**

The transition between reciprocity and patron-client relations has been described for the Chilean middle class and for the informal sector in Mexico (Lomnitz 1971:103-104). 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. It is as if the deficiency in the balance of reciprocity on the side of the less powerful partner were to be made up through loyalty. Basically, then, power transforms inequality into subordination. The more powerful partner becomes a patron, and the less powerful one a client.

Loyalty in unbalanced exchange relations is the basis for political support. In the other cases it may be the basis for action groups in the economy. In this article, however, I describe patronage as a mechanism of informal exchange within the formal sectors of society: large business organizations, labor unions, and the state apparatus. A general discussion of patron-client relations in the formal sectors of Mexico (Lomnitz 1982) shows that 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.

In the Mexican political structure, for example, groups based on patronage survive administrative changes in the hierarchy: subordinates rise or fall together with their patrons. Each politician has a group of loyal followers who accompany him or her from job to job in the civil service. Thus, Chapela (1983) showed how three ministerial changes in a given administration generated successive groups of officials who were beholden to different leaders. These groups were originally based on reciprocity networks between social equals (university classmates, students of a professor who was subsequently appointed to a technocratic position, and so on), so that continuing reciprocity between its members was reinforced by allegiance to a common leader. The ups and downs of politics may produce administrative changes at the top, but followers of the former department heads remained and constituted a faction, even if individuals found jobs in different government agencies. Loyalty often survives hard times, and is rewarded when a member of the faction gains control.

Such informal structures may escape detection by sociological research over limited periods of time, since the patron-client bonds may parallel the formal hierarchy in the state or business organization. But the process of delegation of authority normally follows criteria of
“trust,” which tend to be based on patronage. Undoubtedly, the system attempts to control patronage by ensuring that no single leader entirely dominates an action group; thus each patron’s superior will also place people of his or her personal allegiance in controlling positions throughout the organization, including action groups controlled by his or her clients. The power of patrons is measured by the number of subordinates of their trust.

In the Mexican political system, for example, an undersecretary, on being appointed, places members of his or her “team” in controlling positions, for example, as director-general of the various offices under his or her control. However, the secretary, or the minister, will reserve one or more such positions to be filled by his or her own people, The degree of control exercised by a patron on subordinates is inversely related to the amount of trust and loyalty between them; thus the power of a subordinate is a reward for loyalty to the patron.

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. The main difference with reciprocity lies in the unequal levels of resources or power between the partners of the exchange: patron-client exchange is asymmetrical reciprocity.

Reciprocal exchange turns into a patron-client relation when the relative power levels change. Thus, when a relative or friend is appointed to a high political position, he or she can expect to be approached for patronage, including the award of subordinate posts or key contracts. Former equals become subordinates or clients. However, when the relationship between partners is so close as to be likely to extend beyond the terms of the appointment, the social context may remain egalitarian. It is also recognized, in the case of political friends, that their relative fortunes may become reversed in successive administrations. 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.

Carvajal (1985) studied corruption in a specific office of the public administration in Mexico. He found that covert financial operations depended on the existence of informal patron-client networks whose hierarchy mirrored the organizational structure. Ultimately, these networks functioned as political factions that vied for control. Action groups in business or labor are also largely based on informal patron-client networks. Shantytown teams of bricklayers or carpet layers (Lomnitz 1978) may initially be captained by an enterprising relative who becomes a temporary patron but who may drop back into place within the egalitarian reciprocity network after the job is completed. But if the action group persists and develops as a long-term labor organization, its captain becomes acknowledged as a patron by his subordinates as well as by the contractors who use the captain’s services. In a similar manner, business leaders develop their networks of clients in banking, industry, and commerce; these networks are not only based on economic considerations but also on kinship and interpersonal loyalty. As social distance increases vertically across class boundaries, patronage loses its interpersonal character and changes into payoffs, or market exchange.

As Dore (1984:459-482 ‘ ) has pointed out, “relational” contracts among business people in industrialized nations such as Japan are also based on reciprocity and patron-client relations. He claims that these relational contacts have proved to be more efficient than formal contacts between labor and capital or between different business firms. 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, a mixed
economy dominated by a corporative state, or a socialist system. 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, if not most, decisions there are reasons that are not formally acknowledged that concern primary moral principles of the culture (loyalty, _confianza_) as embodied in institutions such as the family or friendship.

Also, the distinction between reciprocity, patron-client relations, and market exchange is less rigid than was originally assumed by Polanyi (1957). This is because the nature of the exchange (as well as its intensity) depends on social distance and on power differentials between the partners. These are continuous variables, and no two exchange relations are identical or remain invariant in time, if only because the relationship is modified by the exchange itself. Reciprocity changes into patron-client relations, and even market exchange relations may contain elements of clientelism and reciprocity.

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 runs politics, production, labor, and most commercial and cultural activities.

**The Case of the Centrally Planned Economies: The Soviet Union**

Much recent literature has become available on the so-called “second economy” or shadow economy” in the Soviet Union, summarized in Grossman (1977 1 1981, 1983). In this discussion, I also use Soviet expatriate writings, work done by Western scholars based on Soviet literature on economic crimes, and questionnaires given to Soviet emigrés in the United States and Israel (Simis 1982~ Altman 1983). Some valuable material can also be found in books by Western journalists who have worked in the Soviet Union (see, e.g., Kaiser 1976; Smith 1979).

The most common forms of economic activities within the shadow economy include 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 construction teams (shabashniks); brokers who supply contacts, locate scarce supplies, and handle merchandising—, and various forms of bribery (Grossman 1979:837-842).

It is difficult to estimate the share of the country’s total economic activity that corresponds to the second economy, since these activities are illegal and cannot be monitored in conventional ways. O’Hearn (1980:7-9), points out that as the second economy adds to the aggregate supply of goods and services, it also siphons off resources from the formal economy through th4ts and diversion of manpower, thus contributing to the inefficiencies fia~ generate informality in the first place. He concludes that “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), even though this state of affairs tends to teriorate since it runs counter to the system’s ideology make the system dey and the social values.

The Soviet Union is ruled by a two-fold hierarchy: the state _apparel_ and the Party. Each department of the administrative apparatus has a corresponding department in the Party structure, with its own Central Committee. While the administrative apparatus has a near-total
monopoly over the production and distribution of goods and services, employment of labor, natural resources, and communications, the effective political control is in the hands of the General Secretary of the Central Committee of the Communist Party at each level. The First Secretary of the Central Committee of the Communist Party of the Soviet Union is, in effect, the chief executive of the country (Simis 1982:23-25, see also Lewis 1983 on China). Similarly, at all levels within the hierarchy of local, state, or federal organs, the respective First Secretary holds absolute power within his or her realm.

Economic planning is “an organic, fundamental feature of real socialism” (Voslensk, 1978:163). Central planning is the major task of the Nomenklatura (the elite of administrators, Voslensky 1978:38-40). Unfortunately, the ideal rationality of planning is offset by the frequent irrationality of bureaucratic mismanagement or by practices that are based on other forms of logic. The result is a chronic scarcity of consumer goods and other commodities due to inefficiency in production and distribution. The considerable inertia of the bureaucratic apparatus generates and encourages waste, pilfering, and negligence (Bahro 1978:235-241).

According to Voslensky (1978:170-175), the director of an industrial concern is chiefly interested in receiving bonuses, which depends on being assigned an easily attainable production quota in the five-year plan. The director will become a hero only by exceeding the quota by a reasonable amount; any spectacular achievements, however, will raise the quotas for the next plan and provoke the resentment of colleagues. The planners themselves have a vested interest in keeping the quotas relatively low, since a failure of the plan would eventually reflect on the quality of the planning. Also, planners know that the plan will be modified during its execution as a result of top-level pressures or corruption. The workers themselves will cooperate with management in topping a sensible quota, or they won’t be eligible for production bonuses. Thus there is a conspiracy at all levels in keeping production in the middle range.

Another reason for inefficiency is that no one, from the workers to the Central Committee, has a vested interest in the quality of the product. Production statistics are concerned with quantity. The bureaucrats in charge of planning have no access to real information (the production figures they use are padded). In addition, machinery, assigned to specific production cycles is frequently unsuitable or mismatched, raw materials and supplies are unavailable, and so on. The introduction of new technology is often very difficult, since the personnel directly in charge of production have no access to the planners, who may have no technical knowledge. In conclusion, scarcity is due both to the low level of production and distribution, and to the fact that those products that are available on the shelves are of extremely low quality.

Failures and delays in the distribution system have a serious effect on production. The director of an industrial concern depends on the punctual delivery of many essential materials and parts; otherwise, production quotas cannot be fulfilled within the assigned period. The entire staff and workforce also depend on these deliveries for their promotion and bonuses. This situation encourages the growth of an informal economy of brokers and illegal suppliers. Repression of these illegal activities in turn stimulates the proliferation of controls.

Patron-client relationships are also present, particularly within the bureaucratic structures. Eisenstadt and Roninger (1981:233-245) have shown that clientelism may be more widespread in socialist systems than in other industrial societies, particularly among the political elites and sub-elites. They attribute this fact to the “areas of uncertainty” that develop in the interstices of a monolithic political system. According to Simis (1482:61), top officials place their relatives and devoted friends in high positions, and receive regular tribute in the
form of kickbacks. This form of patronage appears to be particularly notorious in certain provinces. In Georgia several leading officials divide the republic into spheres of influence; they take into patronage individual districts, towns and party organizations-, each one has his own favorites. Leaders of that republic were paid regular tribute by chairmen of collective farms and managers of state farms in form of cash, sheep, whole herds which were driven for them from mountain pastures to the capital. The owners of private enterprises made monthly protection payments in the form of money, gemstones, and valuable hand-made rugs.... Each major official has his own sphere of influence and his own clientele by whom he was paid regular tribute in return for protection.[Simis 1982: 61]

According to Willerton (1979:181-182), patron-client relations represent a significant factor of political mobility in the Soviet Union. Clientelism thrives in a wide range of settings, both inside and outside the Party. He concludes that “clients appear to be more susceptible to rapid upward and downward mobility-linked to the mobility of the patron-with Party organization clients showing the greatest mobility” (1979:182). In other words, there are vertical networks of political patronage that roughly duplicate the formal hierarchy. The members of those networks tend to follow the fortunes of the leader who happens to be in a position of power, but leadership may change according to the ups and downs of politics.

These differences arise because of different forms of conceiving primary personal loyalty between kin and friends in different cultures. Thus the Georgian solidarity patterns among kin and friends are not exactly the same as those of the Jews, Armenians, Russians, Chinese, Mexicans, and Chileans. Culturally defined rights and obligations between social categories largely determine informal political and economic activities within the formal sector.

Georgian A Case Study

The work of Altman (1983, see also Mars and Altman 1983) is the result of a study of reconstruction done among Georgian Jews who participated in the shadow economy of the Georgian Socialist Republic until 1968, when they emigrated to Israel as a result of a political upset. This study exemplifies the way the shadow economy operates in the Soviet Union. The central point of this work is the recognition that the informal economy depends largely on social networks for its operation, and that the social networks 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” (Altman 1983:4-6). In Georgia 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 1983:5).

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 (director, production manager, etc.) in the plant.
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 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. High-risk jobs, such as director of planning or Party secretary, were also the most remunerative.

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 240. 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 crisis situations 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 emigrate.

In conclusion, networks are 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 up 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 is, and the more it can grow (Altman 1983:945). The modes of exchange present in these informal activities include reciprocity between social and economic
equals, patron-client relationships including political cliques, and market exchanges. In every instance, trust is a basic element.

**Discussion**

The definition of illegality and the level of controls provided by the formal system determine the type of informal exchange: reciprocity, patron-client relations, or market exchange. The Soviet system features a more extensive use of market exchange in the form of direct payments in return for administrative franchises than, say, the Chilean system. It is also true that the Soviet system has evolved a complex and rigid set of bureaucratic controls in which it becomes less likely to have “the right friend in the right place” for all needs; hence, personal interaction is 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. In case of nonperformance there is no recourse: the purchaser of protection or other informal services must depend on culturally conditioned values of honor and trust.

As we saw in the cases presented, the centralization of power caused lags and inefficiencies in the production and distribution of goods and services. State organs tend to respond to internal problems by a proliferation of bureaucratic controls that aggravate the situation. As a result, the formal economy never catches up with demand: scarcity occurs not only at the consumer level but also in industry, where shortages in critical supplies and equipment interfere with production.

These deficiencies give rise to informal solutions. The “second economy” branches out into most fields of economic activity. Private enterprises, where outlawed, spring 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 become available in this fashion, thus further decreasing the incentive to make the formal economy work. State officials in charge of production and distribution become business people, professional and service personnel engage in private to supplement their official incomes, and so on.

Officials with access to bureaucratic decisions have valuable services to offer. Official controls increasingly take the form of bribes and other exactions in kind. As the system looks the other way, everybody sells goods and services on the side, thus diverting an increasing proportion of state resources into the second economy.

But the persisting illegality of such transactions favors and strengthens highly idiosyncratic, culturally conditioned forms of economic cooperation where trust plays a major part. All informal exchange, from daily shopping to protection money paid to state or party officials, develops within personal networks of reciprocity or clientelism. But these networks function on the strength of a rationale of kinship and friendship values, like the networks of economic and class survival found in Latin America.

Wherever bureaucratic controls play a role in the life of the individual, there we find the institution known as “pull” in America, blat in Russia, cuna in Chile, protetzia in Israel, palanca in Mexico, guanchi in China, and so on. In the Soviet Union, blat means pull or connections that are the basis of an eventual reciprocal exchange among peers who agree tacitly to swap access to scarce goods and services within an ongoing personal relationship. The items exchanged include passing grades for children at school, draft deferments, university admissions, Aeroflot seats, and permits or licenses of all kinds. Reciprocity is always expected, though the equivalences between such services are necessarily “fuzzy” because they are not available on any market (Grossman 1983:103; Smith 1979:88-90).
The points made in this article have less to do with the universality and persistence of such systems of exchange (which are easily explained considering the value of the services exchanged) than with their social embeddedness. Even where legal or social risks are minimal, as in Mexico, the exchange of favors among members of the formal sector develops within a social relationship that implies loyalty, trust, and solidarity. This relationship is not casual or transient like a market transaction; it does not occur at random or as needs arise. On the contrary, it develops on a long-term basis according to unwritten rules depending on social distance between the partners.

The case of the Soviet Union is illuminating because it illustrates the flexibility of the informal system of exchange: reciprocity transforms itself into patronage and market exchange. Thus Grossman (1983b:206--207) describes blat between sales personnel and shoppers: scarce goods are set aside for sale to relatives and friends. Already in this case there is an exchange of money, though not necessarily below the counter. It is easy to see how such exchanges can provide an extra income for the shop attendant as gratuities replace reciprocity when the social distance increases. In any case, a condition of trust must exist between the partners because of the risks involved. The same is true for permits and other bureaucratic services, whose access becomes a marketable commodity.

In Chile such money transactions, particularly between social equals within the bureaucracy, would not be carried out face-to-face but rather through intermediaries or incognito. On the other hand, in the Soviet Union personal relationships involving trust are necessary for security reasons. Thus there arises a double standard of morality: individuals may cheat the system, but there are rules of honor and a strict code of responsible performance dominating the relationships among relatives, friends, and informal activity partners. Violators are ostracized and cannot expect continued access to informal services (Simis 1982:155).

Conclusions

1. The degree of formality and the inability of the formal system to satisfy societal needs give rise to informal solutions. If the formal system is 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.

2. Informal exchange develops within modern formal systems according to the same rules of sociability determined by a particular culture; hence, the informal solutions cannot be understood solely in terms of the laws of supply and demand.

3. As the state apparatus expands and its economic functions become more encompassing, the informal networks of reciprocal exchange and patronage invade the formal system and mimic its power structure.

4. Ideological contradictions between formal and informal systems more often than not strengthen the rationale of friendship and kinship at the expense of official morality.

5. Informal exchanges will take the form of reciprocity, patron-client, or market exchange according to the motives, goals, degree of repression of the exchange, or culturally defined rules of obligation between the partners.

6. Every increase in centralization and every additional attempt to control the economy increases the losses and delays due to inefficiency and thus stimulates the growth of informality as a palliative to scarcity. “The more we organize society, the more resistant it becomes to our abilities to organize it” (Adams 1975:60). “Order” creates “disorder.” The formal economy creates its own informality.
References


Willerton, John 1979 Clientelism in the Soviet Union. Studies in Comparative Communism XII (2; 3):159-211.