

Trust, Honesty, and Corruption:

Theories and Survey Evidence from Post-Socialist Societies

Toward a Research Agenda for a Project of the Collegium Budapest

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Two conflicting stories are told about the impact of the past on societies moving from socialism to market democracy. The first recognizes the overall failures of the planned economies but points to cooperation between family and friends as a means of coping with a dysfunctional system. This sense of community has been broken up by the move to the market and to democracy leading to a loss of trust and an increase in opportunism. The second story stresses the socialist governments' lack of legitimacy – a fact that led citizens to assume that official state actors were self-serving and that rules were irrational. Individual horizons were limited by the difficulties and risks of impersonal, arms-length dealings. The new democratic governments inherited a citizenry with low levels of trust in public institutions and with the habit of relying on inter-personal relations, not public institutions and laws. The first story argues for policies that reinforce interpersonal trust, and the second, for policies that develop trust and confidence in the impartiality and competence of the state.

The topic of honesty and trust in the post-socialist societies touches on issues central to the transition process and its eventual outcome. The issue sits at the intersection of institutional and legal analysis, on the one hand, and the study of norms and public attitudes, on the other. Survey work from the region provides a fairly comprehensive picture of the attitudes of citizens and the managers of business firms in the post-socialist countries. This work also sheds some light on private sector and official behavior and on the nature of public and private institutions. Qualitative evidence from interviews and focus groups provides insight into the way households and businesses cope. Nevertheless, we know less than we would like about the actual operation of government institutions and about private sector organizations and informal groups. The rapidity of year-to-year changes leaves the analyst with questions about what has actually happened and unsure about the proper recommendations for reform.

Most recent work shows a sharp divergence between the countries of the former Soviet Union (except for the Baltics) and those that came under Soviet influence only after the Second World War. There are exceptions and interesting cross-country variations, but as a general rule, the countries geographically closer to Western Europe are also closer to Western Europe in political, legal, and economic development than the countries farther east. This suggests that the most

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pressing problems and their solutions will differ across the region. In some countries, growing poverty and inequality suggest a focus on simply avoiding collapse. Some of the laggards in the region, such as Russia and Ukraine, may need to go through a second transition to escape from dysfunctional traps where distrust in the state and in others builds on itself over time. In other countries, one can consider more fine-grained responses both to create institutions that facilitate trust and honesty and to help change public attitudes and expectations.

Trust has many meanings. Part I distinguishes between three variants: generalized interpersonal trust, one-sided trust or reliability, and two-sided reciprocal trust. It distinguishes between trust that arises from interpersonal interactions over time and trust based that arises from other sources. I argue that the development of legitimate, well-functioning governments and markets requires one-sided trust in public institutions. However, tensions can arise between one-sided trust in institutions and reciprocal trust in friends and family. In my view, the creation of generalized trust is a weak foundation on which to build a modern democratic market economy. Part II begins a presentation of data on the region. It reviews the survey evidence on public attitudes toward the state and on people's actual experience coping with state officials in Central and Eastern Europe. It documents the sharp differences between the western and eastern portions of the former Communist Bloc. Part III discusses the link between the creation of a trustworthy state and the role of participatory organizations and considers how these organizations might increase citizen trust and involvement. Part IV turns to business/state and business/business relations. It focuses not only on firms' relationships with politicians and bureaucrats but also on the way the law and the courts affect business to business dealings. The paper ends in Part V with suggestions for future research and policy analysis.

I. Theoretical Foundations and Empirical Issues

Trust implies confidence, but not certainty, that some person or institution will behave in an expected way.² A trusting person decides to act in spite of uncertainty about the future and doubts about the reliability of others' promises.³ The need for trust arises from human freedom. As Piotr Sztompka (1999: 22) writes, "facing other people we often remain in the condition of uncertainty, bafflement, and surprise."

Honesty is an important substantive value with a close connection to trust. Honesty implies both truth-telling and responsible behavior that seeks to abide by the rules.⁴ One may trust another

² Russell Hardin's (2001: 10) view that trust is a type of knowledge or belief, not an action seems correct although in practice all one may be able to observe is the action that follows.

³ Sztompka (1999: 25-40), Dasgupta (1988: 51). As Annette Baier (1986: 235) writes: "Where one depends on another's good will, one is necessarily vulnerable to the limits of that good will. One leaves others an opportunity to harm one when one trusts, and also shows one's confidence that they will not take it." Diego Gambetta characterizes trust as follows. "Trust (or, symmetrically, distrust) is a particular level of the subjective probability with which an agent assesses that another agent or group of agents will perform a particular action, both *before* he can monitor such action (or independently of his capacity ever to be able to monitor it) *and* in a context in which it affects *his own* actions...When we say that we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of cooperation with him" (Gambetta 1988b:217).

⁴ For a discussion of lying see Bok (1978).

person to behave honestly, but honesty is not identical to trustworthiness. A person may be honest but incompetent and so not worthy of trust. Nevertheless, interpersonal relationships are facilitated by the belief that the other person has a moral commitment to honesty or has an incentive to tell the truth. Corruption is dishonest behavior that violates the trust placed in a public official. It involves the use of a public position for private gain.

The Collegium Budapest project is most interested in honesty and trust as they affect the functioning of the democratic state and the market. We are interested in informal interactions based on affect-based trust only insofar as they substitute for, conflict with, or complement the institutions of state and market. The relationship between informal connections and formal rules and institutions is central to our concern. The institutions of interest are democratic political structures, bureaucracies, law and the courts, and market institutions. Excellent introductions to work on the link between government and trust are books edited by Valerie Braithwaite and Margaret Levi (1998) and by Mark Warren (1999a). As Warren points out, governments are needed in just those situations in which people cannot trust each other voluntarily to take others' interests into account. The state is a way of managing inter-personal conflicts without resorting to civil war. Yet this task is much more manageable if the citizenry has a degree of interpersonal trust and if the state is organized so that it is trusted by its citizens along, at least, some dimensions. The state may be able to limit its regulatory reach if interpersonal trust vitiates the need for certain kinds of state action (Offe 1999). Conversely, if the state is reliable and even-handed in applying its rules, that is, if people trust it to be fair, state legitimacy is likely to be enhanced (Offe 1999, Sztompka 1999: 135-136).⁵ Thus there are three interrelated issues. First, do trust and reliability help democracy to function, and if so, how can they be produced? Second, do democratic governments help create a society in which trustworthiness and honesty flourish? Third, given the difficulty of producing trustworthiness and honesty, how can institutional reform be used to limit the need for these virtues?

This section of the paper provides a framework for thinking about these broad questions and for the factual material to follow. Section I.A organizes the research on trust especially as it applies to the relationship between trust and government functioning. With this background, I.B discusses the mutual interaction between trust and democracy. The alternative of limiting the need for trust leads, in I.C, to a discussion of corruption in government and commercial dealings. Corruption occurs when dishonest politicians and public officials help others in return for payoffs. Because their actions are illegal, they need to trust their beneficiaries not to reveal their actions. Corrupt officials are also, of course, betraying the public trust insofar as their superiors are concerned. Reforms here can involve a reorganization of government to limit the scope for lucrative discretionary actions. Conversely, one might focus on changing the attitudes of both officials and private actors so that existing discretion is exercised in a fairer and more impartial manner.

This section focuses on the issues of trust, trustworthiness, and corruption. Except insofar as corruption is viewed as a type of dishonest behavior, I do not discuss honesty as a distinct and important value. This is a lacuna that will need to be filled as we develop the project's agenda in the May workshop.

⁵ Hardin (1998,1999) argues that it is incoherent to speak of trusting a state institution, but that is because he only considers what I call reputation-based trust.

A. Generalized Trust, Reliability, and Reciprocal Trust

Many claim that societies cannot function without high levels of trust.⁶ Sometimes this claim is coupled with a lament about the decline of trust in the modern world and nostalgia for the days when trust was high and personal involvement in civic life was pervasive.⁷ Sometimes the discussion proceeds as if “trust” in and of itself is valuable as evidence of close interpersonal links. Trust and a strong “civil society” are taken to be synonymous. But disembodied trust is not a very meaningful normative concept. It is parasitic on other underlying substantive values and cannot be evaluated and studied except in context.⁸ The values I emphasize are increases in individual well-being and the creation of states viewed as legitimate by their citizens. Trust is an input in the process of economic growth and state-building that may have negative as well as positive consequences (Putnam 2000: 350-363, Hardin, 2000, Rose-Ackerman, 1999: 96-99).

Although I begin with generalized trust, my main concern is relational trust -- that is, trust in particular contexts, whether one-sided or reciprocal. Although it may be true, as Eric Uslaner (2000-2001) argues, that generalized trust in others has deep roots in individual psychology and upbringing, structural conditions are, nevertheless, important in influencing trust and behavior in particular cases. The tension between trust based on interpersonal empathy and trust based on neutral fairness is my central analytic and empirical concern.

One uninteresting class of cases can be eliminated from consideration right away – simple probabilistic calculations based on natural, physical phenomena, as when someone says: “I trust the sun will rise tomorrow”, or “I trust that the seeds I have planted will germinate if the weather is favorable.” There is no reliance on human agency here. In fact, although such usage is common, it is misleading to refer to “trust” in this context. One is simply making a prediction based only on one’s knowledge of the natural world, and it would be clearer to speak in those terms.⁹ Let us turn then to situations that depend on human decisions whether or not to act in a trustworthy manner.

1. Generalized Trust and “Social Capital”

Generalized trust in others has recently been measured extensively and used as an indicator of the health of society. This type of trust expresses a background psychological attitude rather than trust in identifiable others to do particular things (Hardin, 2001). Such measures of trust are very difficult to interpret and to translate into concrete proposals. The causal links between measures of generalized trust and the performance of government and market institutions are not always well-specified and the empirical tests are inconclusive. It seems especially problematic to make much use of this information in the countries in transition where inter-personal trust often diverges widely from trust in a range of institutions.

Generalized trust is not the same thing as “social capital.” The issues of trust and social

⁶ “In almost trivial ways, without trust the most basic activities of everyday life would become impossible” (Warren 1999:2). See also the sources cited in Sztompka (1999: ix).

⁷ See Robert Putnam (2000).

⁸ As Gambetta (1988b: 214) states: “*A priori*, we cannot always say whether greater trust and cooperation are in fact desirable.” He evokes the example of a group of robbers and murderers who operate on the basis of interpersonal trust. Gambetta’s (1993) own study of the Italian mafia is full of relevant examples. See also Sztompka (1999: 114-115).

⁹ Gambetta (1988b: 218); Luhmann (1988); Sztompka (1999:19-21).

capital have received considerable attention recently because of Robert Putnam's (1993, 2000) claim that when social capital is high, citizens express confidence and trust not only in each other but also in public institutions and the market. According to him, this encourages citizens to work to improve the democratic accountability of the state. Putnam (1993, 2000) argues that strong "civil societies" generate interpersonal trust and tolerance that is transferable from the voluntary organizations and groups that produce it to the broader framework of democratic participation. Under this view, which conflates generalized trust and social capital, societies need to create opportunities for social capital to be produced through voluntary activity based on friendship, loyalty, or commitment. He believes that trust created at that level will aid in the production of the generalized trust useful for the maintenance of a stable democracy.

There appear to be serious problems with Putnam's conceptual framework. The available evidence does not demonstrate a strong link either between trust in people within a particular organization and generalized trust in others or between generalized trust and trust in state institutions. In 1990 and 1996/1997 the World Values Survey (WVS) asked whether, generally speaking, "most people can be trusted" or whether "you can't be too careful in dealing with people" (V 94, Inglehart 1997:399). Generalized trust is associated with stable democracies according to research based on the WVS. In a multi-variate analysis based on 41 cases worldwide, the number of continuous years of democratic functioning between 1920 and 1995 is positively associated with high levels of interpersonal trust as well as with GNP/per capita and expressions of well-being (Inglehart 1997: 183, see also Inglehart and Baker 2000). Although this finding suggests that generalized trust and democracy reinforce each other, it does not imply that the development of generalized trust will generate strong democracies. Recent work by Eric Uslaner (2000-2001) concludes that participation in voluntary institutions does not produce generalized trust in others and does not promote democracy and that democracy does not generate trust even if the two are correlated. In research that is somewhat more supportive of Putnam's claims, John Brehm and Wendy Rahn (1997) demonstrate, with individual-level US data, that the causation runs weakly from interpersonal trust to both civic engagement and confidence in government but much more strongly from both confidence in government and civic engagement to interpersonal trust.

Further reasons for skepticism come from work on generalized trust in the post-socialist countries. Levels of generalized trust are not particularly low. For example, in 1998, 51% of those surveyed in Central and Eastern Europe by the New Democracies Barometer said that most people can be trusted; in 2000, 66% of Russians agreed, up from 34% in 1998. These replies were below the 77% figure for Korea, but they are above recent United States numbers which are hovering at about 35%. There does not appear to be a drastic deficit in interpersonal trust in the region (Rose and Haerpfer, 1998a: 62-63, Rose, 1999a: 13, Rose and Shin, 1998, 16-18, Rose, 2000:29, Uslaner 2000-2001). However, trust in others does not necessarily translate into trust in government. In 2000, Russians expressed high levels of distrust in all institutions except the army and the president (Rose, 2000: 29). Looking across the countries surveyed in the New Democracy barometer, Ukrainians who have low levels of trust in government institutions express a high degree of trust in "most people you meet." In Central Europe, the most distrustful of other people are the Romanians and the Bulgarians, but their views of a range of institutions are not markedly different from those of their neighbors (see table 1 below). Thus, there are some countries where interpersonal trust is high and trust in institutions is low, and some where at least some institutions are trusted although

inter-personal trust is low (Rose and Haerpfer 1998a: 62-63).

Growing interpersonal trust does not necessarily translate into democratic benefits. This is likely to be particularly true in post-socialist societies where appeals to support the “collective good” are often viewed with skepticism (World Bank, 2000b: 199). My critique of Putnam should not, however, be read as a general critique of the concept of social capital and its role in economic and political development. Rather, I would argue for a more nuanced view that does not treat social capital as an undifferentiated mass that is “produced” by participation in voluntary groups. Instead, one needs to understand the different kinds of interpersonal links that develop between people as a result of their personal and organizational ties. Then one could study the way specific types of private organizations and groups influence people’s interactions with the state and the market. Such research could lead to proposals for policies that might facilitate the growth of civil society and social capital, but not necessarily generalized trust.

There seems no reason to assume that a legitimate state will bubble up spontaneously as people become more trusting of those they meet. I argue below that nongovernmental organizations may have important benefits for those concerned with state-building. This connection, however, does not depend on the claim that such institutions increase generalized trust. First of all, they may not do so, and second, even those that do, may not generate large benefits in terms of civic engagement.¹⁰

2. One-Sided Reliability

Moving from generalized trust in others to specific human and organizational interactions, requires more specific models. I emphasize the basic distinction between one-sided reliability or confidence and two-sided or reciprocal trust. Under some conditions, these alternative types of trust can operate at cross-purposes, and thus they raise a number of important problems for the post-socialist countries.

Under “one-sided reliability” person A decides whether or not to trust another person or institution, B, on the basis of information about incentives, motives, and competence. The situation is one-sided in that the trusted person is uninterested in whether A is trustworthy.¹¹ B may, however, be influenced by A’s expected reactions to B’s actions. The situation may involve strategic interactions, but only one of the actors must decide whether to be trustworthy, and only one has to decide whether or not to trust. I distinguish three types of one-sided reliability.

¹⁰ However, experimental work by Toshio Yamagishi’s (2001) using Japanese subjects suggests how decisions to trust particular people can be influenced by one’s general disposition to trust others. This research has nothing to say about how generalized trust is produced; it only deals with the behavior of people who express varying degrees of such trust. People who express high levels of general trust in others are not gullible in the face of contrary evidence. Rather, because they have experience in taking chances on others, they are more skilled at judging the reliability of others than the distrustful who simply avoid encounters where trust is required. Because the distrustful are less skilled at evaluating others, when they do take a chance, they are more likely to be disappointed thus discouraging future transactions. Thus, the trusting may be cheated more often than the distrusting but may gain overall because they engage in so many more transactions, some of which are successful. Those who trust others will take more chances that can produce economic and political benefits. Yamagishi’s work suggests that generalized trust represents, not gullibility, but realistic calculations, at least in Japan. There may, however, be a different underlying pattern in the post-socialist countries. The savvy trusters in Japan are simply making an informed judgment about their countrymen. In Ukraine, these same people might express generalized distrust.

¹¹ This category is similar to Sztompka’s (1999:27) concept of “anticipatory trust.”

A first is reputation-based trust that arises from one's belief that the other can be trusted because it is in his or her interest (Sztompka 1999: 71-72, Wintrobe 1995: 46). Russell Hardin (1998, 1999) calls this "encapsulated interest". A reputation for trustworthiness is beneficial to the individual. In much economic analysis of the topic, trust and honesty grow out of repeat play. The business person is trusted, not because he appears especially moral or good, but because it is in his interest to be viewed as reliable.

If morally good people can credibly signal their character, they have a competitive advantage because they find it easier to convince people that they should be trusted. However, if there is a scarcity of such people, trustworthy reputations can also be developed by the purely self-interested. If information about the outcome of particular transactions is communicated to the world at large, each deal creates spillovers. A seller may act in a trustworthy way, not just to induce the particular buyer to return, but also to send a signal to other potential buyers (Sztompka 1999: 104).

Such a process, in which self-interested people act in a "good" way, has particular appeal for economists who defend the market as a welfare-enhancing institution in which all actors are self-interested. In these models, actors have an incentive to establish a good reputation irrespective of what other economic actors are doing. If they charge the same price, a trustworthy seller will always get more business than an untrustworthy one. The only reason for failing to develop a trustworthy reputation is the cost of communicating one's type to the customer base. There is no need for external law enforcement.

Models of this type may be strategic in that B's incentive to be trustworthy depends on estimates about the behavior of A, who, in turn, bases her behavior on a estimate of B's actions.¹² Consider, for example, the well-known problem illustrated by the used car market. George Akerlof (1970) argues that because consumers are poorly informed, sellers have an incentive to try to sell low-quality cars, "lemons," by passing them off as high-quality cars. This will drive high-quality cars from the market if sellers cannot credibly commit to automobile quality. Customers anticipate this behavior of sellers and will not believe any one who claims to be selling a high-quality car. Then the only kinds of cars that change hands are of low quality. A business person who could establish a credible reputation as a seller of high-quality cars could make money. He might do this over time as satisfied customers report their experience, but he would need some device, such as a money-back guarantee, to get his business started. Alternatively, if he can credibly signal his high integrity ex ante, he can successfully enter the market. This is an example of trust as one-sided reliability in a strategic context. The seller anticipates the buyer's behavior, but the buyer is the only one who needs to exhibit trust. Below I consider strategic cases where trust is a two-sided affair.

A second, related, type of one-sided reliability is trust in a professional with specialized knowledge such as a doctor or lawyer or a scientific expert who predicts the future or who predicts the result of engaging in some risky activity, such as taking a prescription drug or breathing in an air pollutant (Barber 1983, Sztompka 1999:46-48). Just as in the first case, one needs to know if the person's material incentives are aligned with one's own interest in the truth or in reliable service. However, also of importance are the expert's competence and reputation for unbiased judgment. She is trusted both because she is highly skilled and because she holds professional norms that value

¹² The cases that Hardin (2001:17-18) discusses are mostly of this sort and derive from conditions that approximate the prisoners' dilemma.

trustworthy behavior and truth telling. These norms should dictate honest reporting of scientific tests even if they are contrary to the expert's expectations. For lawyers and doctors, they should induce such professionals to act in the interests of their clients and patients. Trust is one-sided here because, although those who rely on the expert must trust her, the expert, herself, is uninterested in the trustworthiness of those who use her predictions and services. The exception here would be a provider of professional services who cares about her clients' reputation for paying their bills

In the United States there appears to have been a decline in public trust in scientific experts. According to Paul Slovic, lack of trust underlies a number of recent controversies over technological hazards (Slovic 1993). For example, the risks of nuclear waste disposal and exposure to chemicals are viewed as unacceptably large by ordinary people even though experts evaluate the risks as low and comparable to risks that people do accept. The problem is not a failure to communicate the relevant data but a lack of public trust in its reliability (ibid.:676). In this area, trust is fragile since a single, highly visible, negative instance can undermine trust in experts' claims. Furthermore, the public views the sources of trust-destroying news as more credible than those that provide news that reinforces trust. A negative piece of news can lead one to interpret subsequent information in a negative light thus amplifying the effect over time (ibid.: 678-679). One solution is to limit public participation. In France the public perceives the risks of nuclear power to be high but trusts the state to manage them even though it accepts little public input. This is not an acceptable solution for more participatory systems such as the United States. Instead, Slovic tentatively recommends more power sharing and public participation that goes beyond public relations (ibid: 680). The claim that trust built on democratic participation will help increase the credibility of science in policymaking.

The level of trust in professionals is likely to be lower in the countries in the post-socialist world, given recent past experience. If experts and professionals were distrusted under socialism, it is not obvious that the same people would suddenly be seen as more reliable under more democratic systems.

The third type of one-sided model is not tied to individual motivation, but to organizational functioning.¹³ This is rule-based trustworthiness – that is, trust that an organization's rules will be followed in a neutral and predictable way. One trusts the institution's rules irrespective of the particular people occupying positions of trust and authority. It is easy to see why those at the top of an organization might want to create such standards, but it is less clear how inferior officers can be induced to behave in a rule-bound way. There are several potential problems. First, how easily can one find out ex post if the official or employee acted badly? Are there other intervening variables, so that a poor outcome does not necessarily imply that the expert acted badly? Second, if monitoring is possible, can costs be imposed? Third, how costly is it to monitor and to impose costs? When the answers to these questions are unfavorable, the solution may be to reduce the human element in administration. One might simply limit the conditions under which trust is needed (Gambetta 1988b: 220, Levi 1999).

As Niklas Luhmann (1988: 99-105) points out, social evolution toward increasingly complex societies may increase the benefits of trust in public agents at the same time as it undermines trust based on family and friends. Hierarchies of agency/principal relations expand the

¹³ Sztompka (1999:44) calls this "procedural trust."

scope of organizations and permit the use of specialists. The functioning of these organizations is closely related to the reliability of these agents. Even without hierarchy and specialization, trust can facilitate arms-length activities organized over space and time or indeed any activity in which monitoring is costly.¹⁴ Thus, as we shall see in discussing reciprocal trust, Luhmann has focused on an important tension that arises in the post-socialist countries. They need to create trustworthy modern organizations to exercise state power and private economic activity, but doing so may undermine older reciprocal methods of coping.

3. Reciprocal Trust

Now consider "reciprocal trust." Frequently, all participants are affected by the attitudes and expected behavior of those on the other side of the transaction. These cases differ from the strategic interactions listed above in that people have a reciprocal relationship based on trustworthiness. Trustworthy behavior can be affected by one's guesses about the trustworthiness of others. The links may be based on mutual calculations of the others' interests, on feelings of personal affection and responsibility, or on shared values (Gambetta 1988b: 230-231, Hardin 2001). Because links of trust between two people can inflict harms or benefits on others, the discussion of honesty and trust needs to be embedded in the institutional structures in which people deal with each other.

First, as Russell Hardin (2001) argues, mutually reinforcing trust can be interest-based. All that is required is to take a situation where encapsulated interest operates on one side of the transaction and graft it onto another where trust flows the other way. Reciprocal trusting relationships may involve individuals with very different degrees of power and with very different aims. Even in a straight hierarchical relationship where a principal (superior) requests an agent (inferior) to do something, trust does not flow only from the trusting superior to the trustworthy agent. Rather the agent also trusts the superior to carry out her side of the bargain by, for example, paying him when the job is done. When economic relationships are organized over time, A, the one who acts first, may trust B, the second mover, to act as promised, or A may write an enforceable contract that reverses the burden of trust. For example, A may require B to give him something of value to hold as a hostage against B's performance. B will not do this, however, unless he trusts A not to abscond with the hostage. In many relationships the unfolding of interactions over space and time means that people shift from being the one who trusts to being the one who is trustworthy and back again. Over time, the very act of trusting may induce the other person to be more trustworthy, and so on in a benevolent spiral. Conversely, showing a person that he is distrusted may cause him to confirm your expectations (Sztompka 1999: 28, 61-62, 106).

Second, reciprocal trust can be a reflection of warm personal feelings. People may trust others because they believe that the others wish them well. However, one needs to recognize that close personal relations can engender hatred and jealousy as well as love and affection, and sometimes the latter can turn into the former. Distrust is sometimes pervasive in close-knit communities that give people little possibility of exit (Levi 1998:82-83). Furthermore, trust in a network of close kin or ethnic group members may reduce trust in outsiders (Wintrobe 1995).

Third, reciprocal trust can reflect shared values and goals, not empathy. People trust each

¹⁴ Nicholas Luhmann (1979, 1988: 99) emphasizes how trust in strangers who are part of institutions can help coordinate activities over space and time in a way that permits complex, differentiated societies to function.

other because they have a common belief in the moral value of cooperative and helpful behavior (Braithwaite, 1998). Trust motivated by moral values, such as respect, may be extended altruistically (Mansbridge, 1999). This type of trust can reinforce the legitimacy of public institutions and overcome cooperation problems such as the prisoners' dilemma under which those who anticipate the self-interested behavior of others behave in a self-interested way as well. A person may cooperate, not only because she views cooperation as good, but also because she believes that you share her belief. The key is not trust per se but a mutually trusting relationship.

However, reciprocal trust can generate patterns of behavior that actively undermine state functions. This can be viewed as positive or negative depending upon one's evaluation of the state. On the one hand, close-knit criminal groups may create networks based on a mixture of empathy, threats, and shared goals that leave the ordinary police powerless (Gambetta 1988b: 214, 1993). On the other hand, organizations based on interpersonal solidarity in the face of an illegitimate state can sow the seeds of revolutionary change. Such groups were important in setting the stage for the fall of the socialist states in Central Europe although they obviously could not have achieved the change entirely on their own (Sztompka, 1999: 151-160, Warren, 1999b: 12-14, World Bank, 2000b: 118).

If cooperation is fragile and subject to breakdown, one option is to develop strategies that minimize trust (Levi 1999). Thus Robert Axelrod (1984) showed that a strategy called "tit for tat" performs best against other strategies in a repeated prisoners' dilemma game. Under that strategy, a player cooperates in the first round, but if the other player opts not to cooperate, the first player fails to cooperate in the next round and continues to play that strategy until the other player opts to cooperate. When he does, the first player cooperates in the next round and so on. This strategy requires no trust at all. A player simply communicates his intentions clearly by the moves he makes, but the result can be to establish long-term cooperation. Nevertheless, the strategy may be more effective if the tit-for-tat player announces his strategy up front and if the other player trusts his credibility (Gambetta 1988b: 222-229). Notice that the tit-for-tat player wants the other player both to trust that cooperation will be met by cooperation *and* that failure to cooperate will be swiftly punished. A person with too strong a reputation as a cooperator might not be able to develop a credible reputation for retaliation. The other player trusts him to cooperate but does not trust him to inflict punishment.

Now consider interactions between large numbers of people with no collective organization. Especially when reciprocity is based on moral motivations, the overall level of trustworthiness and honesty can be affected by the proportion of others who are also trustworthy and honest. When a high proportion of actors is trustworthy and honest, this encourages others to become honest, and so on until all but a few diehards are honest. Conversely, when most are distrustful and dishonest, even more shift in that direction until all but the moralists are lying and cheating. Moral qualms are not absolutes but are affected by one's perception of what others are doing (Fehr and Gächter, 2000; Sugden, 1984).

A similar dynamic can operate when behavior depends on the chance of being caught behaving in a dishonest or untrustworthy way. In one version of this model, the monitoring process breaks down as the proportion of cheaters increases. One's behavior is affected by the trustworthy or honest behavior of others, but one's motivation is pure self-interest. In another version, one's expectations about those on the other side of the transaction are key. You will be more likely to offer a bribe if you expect that most officials are corrupt. Then even the formerly honest will be

offered bribes, and some may become corrupt when offered the opportunity. If you think most are honest, you will be deterred from offering a bribe for fear of being arrested and hence few potentially corrupt officials will actually accept bribes, leading them to turn honest as well. Similarly, a person may behave in a trustworthy way toward his family members if they reciprocate, but revert to feuding if they cheat or undermine him.¹⁵ A spiral in which distrust breeds more distrust can be particularly destructive in complex societies. A decline in confidence or an increased difficulty of finding others who warrant trust can unleash a deteriorating cycle that diminishes the range of activities that people are willing to carry out.

These dynamic models appear consistent with Putnam's (2000) view of the decline of generalized trust in the United States. My point, however, is that Putnam's analysis takes insufficient account of strategic considerations. People who express high or low levels of generalized trust may trust others in one strategic context, say involving neighborhood cooperation in a common task, and distrust others in another, say in deciding whether to pay taxes or apply for a scarce public benefit. In these dynamic models there is no generalized "social capital." Instead, behavior is a function of the particular situation, including estimates of the probable behavior of others.

4. A Typology and a Tradeoff

Research on trust can be organized in terms of the interrelationships between people, on the one hand, and the origin of individual trusting or distrusting attitudes, on the other. I make a preliminary attempt to isolate the most important factors here, but my framework is designed to promote discussion, not set up rigid categories.

Consider, first, the interpersonal dimension. I have isolated three broad categories:

1) Generalized trust: One's trust in others is part of a general attitude, not an evaluation of the particular, interpersonal situation. Its origins, however, may lie in one's past experiences of one-sided reliability or reciprocal trust.

2) One-sided reliability: Individual A's trust in a particular person, B, depends upon an estimate of B's trustworthiness. B's trustworthiness, however, is independent of A's own trustworthiness. However, B's behavior may be influenced by reactions of those on the other side of the transaction and by the costs of monitoring and control.

3) Reciprocal trust: Trustworthy behavior is influenced by the degree of trust and trustworthiness expressed by others. The relevant others may be (i) the people one deals with directly who are on the other side of the transaction, or (ii) others similarly situated such as other firms in the same industry, fellow public officials, or other applicants for scarce public services.

The second dimension involves the process by which trust is generated either through repeated interactions or through psychological or moral attitudes. I have isolated five broad categories, but they are not mutually exclusive. Several can co-exist at once. Then it will be important to determine which reinforce each other and which operate at cross purposes. These categories interact with the interpersonal alternatives above although some appear to be more closely associated with one than with another. The five categories are as follows.

a) Encapsulated interest: Trustworthy behavior that develops over time as a part of people's efforts to develop a reputation for reliability. Of course, such a reputation must be

¹⁵Some of these models are summarized in Rose-Ackerman (1999: 107-108, 124-125).

valuable so that the interest of customers or citizens in reliability influences the decision to supply it. This can produce one-sided trust when a feedback loop operates that is tied to the actor's narrow self-interest. Alternatively, in the two-sided case, interest-based trust can develop in which actors have an instrumental incentive to act in a trustworthy manner to further other goals. These other goals might be economic, political, or moral but are distinct from trustworthiness per se. An important empirical issue is whether trust developed out of encapsulated interest can produce generalized trust in others.

b) Expert-based: Trust in experts who make predictions or provide services based on science or other forms of professional expertise. This will be mostly one-sided trust in which ordinary people trust experts, but the experts, in turn, have no interest in the trustworthiness of ordinary people.

c) Rule-based: An organization is trusted because it promises not to deviate from clearly-stated procedures that treat people neutrally. This is one-sided trust in an institution, but if that institution is the state, its trustworthy reputation can make people more willing to trust anonymous others.

d) Affect-based: Trustworthy behavior is encouraged by love and friendship. This could involve a one-sided relationship, or it could be influenced by the vulnerability and trust of those who depend on you because of ties of kinship and affection. In other words, the other person need not be trustworthy, but his or her trust in you influences your behavior.

e) Morality-based: Beliefs in the trustworthiness of others are reinforced by interactions with others who have moral commitments to act in a trustworthy way, and vis versa if others are untrustworthy and dishonest. Moral behavior may be motivated by the impact on third parties not part of the transaction. Generalized trust may be the result of interactions over time with others who believe that trust is morally right.

This way of organizing the concept of trust can help one isolate tradeoffs, conflicts, and complementarities between alternative types of trust and trustworthiness that can be expected to arise as the state-building process proceeds in Central and Eastern Europe. The most obvious tension is between reciprocal trust and one-sided trust in the fairness of public institutions and markets. Interpersonal trust based on empathy and a sense of duty toward family and friends is quite different from trust in the fairness and neutrality of officials and institutions that govern modern complex societies.¹⁶

In complex societies, one-sided trust based on reliable predictions is especially important. Unfortunately, reciprocal trust based on personal connections may operate at cross-purposes to trust as reliability. Organizational designers and legal reformers frequently seek to create systems that operate fairly and without favoritism. This goal can come in conflict with reciprocal, affect-based trust that depends upon close personal relations or kinship. One who relies on affect-based trust may believe that the trusted person will favor her whether or not she fulfills the formal qualifications and will aid her even if it imposes some costs on him in his institutional role. In a world where affect-based trust is dominant, there may be little trust based on the notion of trust as reliability. The development of a modern, complex society may be stifled.¹⁷ For example, the risks

¹⁶ Claus Offe (1999) distinguishes between expectations of reciprocity in interpersonal trust and trust in institutions on the basis of knowing that its rules, values, and norms are shared by participants who view them as binding.

¹⁷ Inter-personal trust based on ethnic group membership may exclude non-members and make exit all but

of kin-based trust are illustrated by a detailed study of two Northern Albanian villages. In one village five extended families dominated village life and cooperation across kinship lines was limited. In the other, family groupings were less powerfully entrenched and community-wide cooperation was possible and successful. In another example from Central Asia, some indigenous neighborhood institutions have used donor funds to favor insiders with close ties to the leadership.¹⁸

Even trustworthy and honest behavior that is motivated by moral beliefs, not kinship ties, may undermine some kinds of rule-based systems. Superiors in an organization may want clear, neutral rules that ignore individual circumstances. The official who is motivated by his own moral beliefs may be just as harmful to efforts to construct a rule-based system as the one who favors his nephews. A person who follows his ideological or religious beliefs no matter what role he plays can undermine efforts to develop trust in public institutions through promises of rule-based service delivery. Conversely, a credible background of rules can encourage interpersonal trust. Once these trusting relationships are established, the participants are less dependent on the background rules, but such relationships would have been difficult to establish in the absence of rules.

Research on the possible tension between trust in rules and reciprocal trust between people is central to understanding the problems faced by the post-socialist countries. Of particular concern are situations where personal links undermine reform efforts. Unfortunately, surveys do not permit one to distinguish between trust in strangers and trust in friends, co-workers, and kin. However, other evidence suggests that Russians and Central and East Europeans established dense networks of informal connections to cope with the difficulties of life under socialism and that some of these practices have continued as ways to cope with the present situation (Rose 1999a:10, Ledeneva 1998). One question raised by the transition is whether the legacy of these informal connections is helping or hindering the process of institutionalizing democracy and the market. Some information suggests that Russia, Ukraine, and other parts of the former Soviet Union are diverging from the countries closer to Western Europe. The reliance on interpersonal ties is understandable but may make some types of reform difficult.

A little insight into the impact of interpersonal ties is generated by a study using Russian data that linked measures of social capital and individual attributes to individual income security (Rose, 1999a). The dependent variable is whether one can borrow a week's salary from friends. Basic socio-economic characteristics such as age, gender, and income had little explanatory power. Feelings of control over one's life did have a positive impact although the causal arrow here is unclear. The most interesting finding concerns the "frequency of using anti-modern networks"--in other words, the use of corruption and connections in a range of different fields.¹⁹ This was an

impossible. In the inter-generational context, the trust that parents place in their children comes from the shame and guilt that children feel as a result of pressure not just from parents but from other members of the ethnic group. A society divided into a collection of ethnic groups may operate with little cross-ethnic economic and social activity thus limiting social and economic development. Ethnic groups might make it easy to develop a trustworthy reputation and impart useful social values that maintain social order, but they can also create prejudice and hostility among groups (Wintrobe, 1995)). This issue of ethnic solidarity arises in Central and Eastern Europe where Russian minorities exist and where boundaries have left ethnic groups such as Hungarians located in several countries. Of course, the Roma present special issues of in-group trust and prejudice in the broader society.

¹⁸ World Bank, 2000b: 199, 203. The Albanian study is by Douglas Saltmarche.

¹⁹ The variable measures the use of corrupt or clientelistic networks for housing repair, getting an apartment, personal safety, theft, portfolio investment, social benefits, permit, getting to see doctor, hospital treatment, getting into a

important explanatory variable both for employed people and for a larger sample of all respondents. These results may indicate that those who use such networks have a circle of friends willing to help with both private favors and the illicit allocation of state services and regulatory benefits. This is a troubling implication since it suggests the relative solidity of networks of obligation based, in part, on corruption and clientalism. A family connection to the Communist Party also has significant explanatory power, indicating that some people are relying on links forged under the previous regime. These results, in short, suggest that some of the trusting relationships in Russia are a legacy from the Soviet period. Connections may help people over difficult patches in their day-to-day lives but do not appear to be contributing to long term reform of the state administration or to the consolidation of democratic structures. In short, an important research topic is the impact of past relationships on present efforts to establish a new legal and institutional framework that relies on democratic accountability and impartiality.

B. Trust and Democracy

Large democracies govern themselves through political representatives and other kinds of agents such as bureaucrats and judges. Because elected representatives cannot be perfectly controlled by voters, the electorate must have some level of trust in those it elects. Similarly, bureaucrats and judges also have considerable discretion. The more they can be trusted to fulfill their roles willingly, the fewer the resources needed to monitor and discipline them, and the more discretion they can be given. The key requirement here is for one-sided trust based on the reliability or trustworthiness of public officials.

Piotr Sztompka (1999: 146-148) lists the ways in which trust contributes to democracy. The most important omission from his list, in light of my framework, is reciprocal trust based on kinship, love, and friendship. Although he does not explicitly deal with the downside of this type of trust, the omission is consistent with my own emphasis on the tension between friendly reciprocity and legitimate democratic functioning. According to Sztompka, democracy requires communication, and trust facilitates communication by helping people both to speak and to listen. Democracy requires tolerance of difference, and trust in others is part of accepting differences rather than seeing them as threats. Mutual trust keeps public debates from degenerating into personal attacks. These three claims depend on reciprocal trust that derives from moral commitments. Sztompka also argues that democracy requires people to accept some basic rules of interaction. Trust in others makes people more willing to play by the rules since they anticipate that others will do so as well. People need to trust both public institutions and other people in order to be willing to participate in politics. These two aspects depend upon the rule-based character of the state, that is on its reliability or trustworthiness. To the extent that one trusts other people, it is because they operate under the same set of rules, not because of love and friendship. Finally, people need information in order to be responsible citizens and in this connection they need to be able to trust the sources that provide this material. This is one-sided trust in expertise. Thus the link between trust and democracy is multi-dimensional and an increase in trust along one line, say in the reliability of the information provided by the media, has no necessary spillover benefits for other dimensions.

If we accept at least some of the items in Sztompka's list, we need to ask how

trustworthiness can be created in society. I have already expressed skepticism about Putnam's (2000) view that the solution is to encourage people to join civic organizations that generate interpersonal trust that produce "social capital" which in turn helps promote accountable government. Nevertheless, as I argue below, nonprofit organizations can help in development of a legitimate democratic state and in the creation of a civic consciousness. However, the mechanism is much different from the one that Putnam posits. An alternative is to take the psychological makeup of the population as given and design institutions, both political and bureaucratic, that function in low-trust environments. I discuss that option below and suggest that the evidence on Central and Eastern Europe suggests that such institutional approaches have promise.

The causation, however, may run in the opposite direction. Some claim that a well-functioning democratic government can create interpersonal trust (Warren 1999c, Rothstein, 2000, Levi, 1998: 85-94, Stzompka 1999: 139-146, Cohen, 1999). To Piotr Stzompka, democracy imposes credible constraints on politicians and public officials. Trust is then a rational response, not a result of "blind" loyalty, and permits people to take risks in dealing with each other in both the political and the economic sphere. "The more there is institutionalized distrust, the more there will be spontaneous trust" (Stzompka 1999: 140). When these constraints collapse, an inverse case can occur, where distrust and recrimination generate more of the same in the next period leading to a deterioration of state legitimacy and functioning and a breakdown of economic relations that depend on a reliable legal and political system.

"Government" is too undifferentiated a concept to be analyzed as a whole. One needs to consider the trustworthiness and honesty of elected politicians and other political actors, of bureaucrats up and down the civil service, and of the judiciary. A competitive electoral process can give politicians an incentive to reveal the untrustworthy behavior of their opponents and to be trustworthy themselves. One problem here is the possible tension between keeping one's promises to campaign contributors and powerful interest groups, on the one hand, and representing the interests of ordinary citizens, on the other. This a familiar tension in all democracies, but may be of special concern in the post-socialist countries where parties and political groupings with mass membership may be relatively weak and not well organized. The creation of a well-functioning representative government is a challenge in these countries given the legacy of distrust in politicians inherited from the past.

Jean Cohen (1999) and Margaret Levi (1998) emphasize the importance of governmental institutions in effecting a shift from a low-trust trap to a more functional situation. Like Stzompka, Levi focuses on the fair and transparent operation of government, in other words, its rejection of affect-based trust in its dealings with citizens. According to Levi, most important are "the capacity to monitor laws, bring sanctions against lawbreakers, and provide information and guarantees about those seeking to be trusted" (ibid.:85). In her work, the focus is not so much on democratic electoral structures as on bureaucratic and legal institutions that make government transparent and fair. These institutions should be designed so that officials have an interest in behaving in an honest and trustworthy way (ibid.: 87). Then there may be a positive feedback loop between interpersonal trust and trustworthy government. Levi draws a useful distinction between the government's credible commitments and fair procedures, on the one hand, and citizens' feelings of ethical reciprocity, on the other. People are more likely to comply with the rules set down by the state if they think the rules will be enforced in an evenhandedly way. Compliance is also enhanced by the

belief that others are also obeying the rules (ibid.: 87-93). The trustworthiness of government encourages widespread compliance with the rules. In the next iteration, even more people comply because they are influenced by the widespread compliance of others.

Rothstein (2000) accepts the self-reinforcing nature of well-run governments and interpersonal trust, but he argues that purely institutional changes will be insufficient. Rather he draws on work on "collective memory" to argue that policymakers can engage in a process that makes creative use of a country's history to emphasize precedents that support trust both in the state and in other people. He urges that culture or history not be taken as arguments for accepting a low-trust status quo. Rather he urges a political dialogue about the nature of a nation's collective memory as part of the process of reform.

Along the lines of Rothstein's proposals, Charles Sabel (1993) presents a case in which trust was generated in a formerly distrustful environment through a process that redefined the actors' identities. The case involved efforts to revitalize the garment, foundry, injection-molding, and machine-tool industries in particular regions of the Commonwealth of Pennsylvania. Sabel develops the notion of a "reflexive self" who "can entertain and act on the idea of creating or extending common values regarding loyalty and forbearance in the face of vulnerability precisely because it knows that other selves can entertain and act on the same idea" (ibid.: 1142). In the process of building trust, the actors "create a past in which prior conflicts resulted from mistakes and misunderstandings rather than fundamental differences" (ibid.: 1146). In the Pennsylvania cases, the key was the development of networks of local people who worked together to propose solutions. In spite of industrial histories of competition and conflict, many of these people had worked together cooperatively on other projects in the past and this background was used to develop a sense of community membership. These cases might provide an outline for similar exercises in Central and Eastern Europe.

Nevertheless, one should not under-emphasize the difficulty of the policies that Rothstein and Sabel propose. Dialogue may be difficult because one person's fair and transparent rules are another's rigid and inhumane system. Thus, the policy debate is not just about the impact of the past on the present, but also about how the state should be structured. Rules and laws need to be seen as fulfilling valid functions, not as arbitrary impositions by unresponsive outsiders. The enforcement process must also be viewed as fair. Otherwise the positive feedback loops outlined by Levi will not operate, and the attempt to establish rules and enforce them may backfire. Those who might have complied out of a sense of altruism or citizen duty may operate in a narrow self-interested way or even turn their resentment at the system into collective action designed to undermine the rules (Frey 1997b, Kahan 2000).²⁰

Work on tax compliance suggests that in the United States a sense of duty and trust in government are more important than deterrence policies in explaining compliance. However, one difficulty with interpreting these results is that most people are very poorly informed about the actual probabilities of audit (Scholtz, 1998). In Minnesota when a sample of taxpayers was sent a letter telling them that the audit probability was one, low and middle income taxpayers increased

²⁰ The dynamic here is very similar to that outlined by Bruno Frey (1997b) who argues that establishing a market in certain goods and services may undermine altruistic motivations to donate to provide these same benefits.

their tax payments compared with a control group.²¹ Bruno Frey (1998) also finds that higher levels of tax enforcement did not increase Swiss tax collections and that offers to pay citizens to accept hazardous waste in their communities are counterproductive. A study of community activists and welfare beneficiaries in Australia found that their distrust of government was founded on a belief that government did not trust them to articulate their own needs and to manage programs designed to benefit the community (Peel, 1998).²² These results suggest that reciprocal trust between government agencies and individuals can produce positive results. Here trust is not based on empathy or love but on mutual respect. In fact, government may trust citizens to administer public programs or pay taxes because it believes that citizens will not rely on interpersonal empathy in deciding how to comply with public responsibilities. The state is more likely to devolve authority to local groups if it believes that narrow favoritism can be avoided.

In relating democracy and trust, I have highlighted the tension between interpersonal trust based on empathy for particular individuals and the creation of a state whose citizens expect fair treatment from each other and from public officials. People who trust each other to obey the rules also trust others not to favor their friends and relations when that conflicts with a civic responsibility. This is not to say that democracies do not value family ties and friendship but only to point out that a commitment to liberal democracy implies a commitment to rule-based, reliable state institutions that screen out most types of affect-based, reciprocal trust.

To proceed with the discussion of trust in the reliability and fairness of government agents, I consider an important case where such trust breaks down. When officials are corrupt, they betray the trust bestowed on them by the citizenry and act in the way that favors those who make payoffs and/or those with whom they have a reciprocal trusting relationship. Understanding the incentives for corruption and the ways it can be controlled, helps one see how government legitimacy might be accomplished without a moral transformation of the population.

C. Economizing on Virtue: The Control of Corruption

Untrustworthy elected officials and bureaucrats are frequently corrupt. They substitute private benefits for public responsibility. If officials are generally untrustworthy, ordinary people and businesses may believe that the only way to get what they need is through a payoff. Furthermore, if most officials are known to be corrupt, people may also seek things to which they are not entitled, such as tax breaks or waivers of costly regulations. Officials in turn may create extra rules and regulations and contracting opportunities in order to profit personally. Politicians

²¹ High income taxpayers lowered their payments, but it seems difficult to see this as a reflection of a loss of moral commitment. The authors make the following argument. If audited, one's ultimate tax liability will be positively related to one's reported income because tax collectors are not perfectly informed. However, one is more likely to be audited the greater one's underpayment. These effects pull in opposite directions. However, if the audit probability is one, only the first effect operates (Slemrod, Blumenthal and Christian, 2001).

²² As Gambetta (1988b:220) notes: "coercion exercised over unwilling subjects B who have not pre-committed themselves to being prevented from taking certain courses of action or who do not accept the legitimacy of the enforcement of a particular set of rights B while demanding less of *our* trust in others, may simultaneously *reduce* the trust others have in us. It introduces an asymmetry which disposes of *mutual* trust and promotes instead power and resentment. As the high incidence of paranoid behaviour among dictators suggests, coercion can be *self-defeating*, for while it may enforce 'cooperation' in specific acts, it also increases the probability of treacherous ones: betrayal, defection, and the classic stab in the back."

may demand payoffs in return for passing laws or issuing regulations, and they may even threaten to promulgate restrictive laws if not paid to desist. Corruption is a coping strategy in the face of untrustworthy, dishonest officials, but it may also be part of a conscious private-wealth-maximization strategy orchestrated by these same officials.

Paradoxically, a deeply corrupt regime usually operates with a high degree of reciprocal, affect-based trust. Because bribers and bribees are operating outside the law, they need to trust each other in order to maintain their relationships. They may design schemes that minimize the possibilities of betrayal, such as making payments only when corrupt services are delivered, or that limit the costs of betrayal, such as the use of middlemen. Nevertheless, the risks that one side will betray the other can be substantial so that links based on kinship or friendship can be important ways to lower the risk. The corrupt official is an untrustworthy and dishonest agent of the public interest but a trustworthy friend and relative.

To understand corruption one needs to clarify what is being bought and sold in a corrupt transaction. It will do little good simply to deplore the small number of trustworthy officials and the citizenry's willingness to pay. Instead, one needs to understand the incentives for making and accepting payoffs. Reforms can then be directed in two directions. First, one may reduce the opportunities and the net financial benefits of giving and receiving bribes and illicit campaign contributions. Second, one can try to shift the attitudes of politicians, public officials, and citizens away from personalized corrupt relationships toward the view that the state has obligations to the citizenry to provide fair and efficient service. For officials, this means replacing particularized, affect-based service delivery with fair and impartial state institutions. Officials become trustworthy agents of the state, not trustworthy friends and relations. For citizens, this means a willingness to demand more of the state than they have in the past. Thus this second reform direction involves both changes in public attitudes toward government and the creation of institutions that can channel public demands for government reform.

My aim here is not to provide a full analysis of the problem of corruption.²³ Instead, I first outline the major economic functions that corruption serves for those who pay bribes. Reforms within each category can reduce the incentives both for those who pay and for those who accept or demand payoffs. Such reforms take people's underlying psychology as given and ask how behavior can be modified. Second, I consider reforms designed to have a more general impact on the trustworthiness of all types of officials and on their accountability to citizens. I do not discuss the full range of possible reforms in government structure and accountability but concentrate instead on those that increase citizens' role in demanding change.

1. Economic Incentives for Corruption

All states, whether benevolent or repressive, control the distribution of valuable benefits and the imposition of onerous costs. The distribution of these benefits and costs is generally under the control of agents who possess discretionary power. These agents are either bureaucrats with obligations to superiors or politicians who are meant to be agents of the public. Private individuals and firms who want favorable treatment may be willing to pay these agents. The problem arises from the fact that the payee is an *agent*. The agent is responsible to a principal whose goals will seldom line up with those of the "paying customer." Payments are corrupt when they are illegally

²³ For a more comprehensive view see Rose-Ackerman (1999).

made to public agents with the goal of obtaining a benefit or avoiding a cost. These payments are not merely transfers. Like legal prices, they affect the behavior of both payers and recipients. They violate the trust placed in officials by their superiors and the general public.

Six broad, sometimes overlapping, categories capture the most important incentives for corruption. (1) The government may be charged with allocating a scarce benefit to many individuals and firms using legal criteria other than willingness to pay. (2) Officials in the public sector may have little incentive to do their jobs well, given official pay scales and the level of internal monitoring. (3) Private firms and individuals seek to reduce the costs imposed on them by governments in the form of taxes, customs duties, regulations. (4) Governments frequently transfer large financial benefits to private firms through procurement contracts, privatization, and the award of concessions. (5) The judiciary has the power to impose costs and transfer resources between litigants. (6) Elected politicians can accept illegal payoffs both to fund their campaigns and to enrich themselves. They may, in turn, pay off voters.

a. Payments that equate supply and demand

Governments frequently provide goods and services for free or sell them at below market prices. In modern welfare states, including the post-Socialist countries, these services include such basic services as health care and education. Corruption of this type has several possible efficiency consequences. First, the goals of a program may be undermined if the services are provided only to those with the highest willingness to pay, excluding the needy or the well-qualified. Corruption in health care and subsidized housing provide two good examples. Second, corrupt markets are likely to differ from open competitive ones. Because of the illegality of bribery, information about bribe-prices will not be well publicized, and prices may be sticky because of the difficulty of communicating market information. Some potential participants may refuse to enter the market because of moral scruples and fear of punishment, and public officials may themselves limit their dealing to insiders and trusted friends. A corrupt system may be not only less competitive but also more uncertain than a legal market.

Furthermore, many officials can exercise monopoly power by determining the quantity of services provided. The corrupt official, like a private monopolist, may seek to supply less than the officially sanctioned level or seek to provide an increased supply if the government has set the supply below the monopoly level. Officials may have sufficient monopoly power to create scarcity even when the service is not scarce, either by delaying or withholding benefits unless paid bribes.

Finally, bribes are frequently paid to permit unqualified people and firms to obtain a benefit. Students might pay to alter the results of university admission tests, or people might pay doctors to declare them eligible for disability payments. Andre Shleifer and Robert Vishny (1993: 601) call this case "corruption with theft". Clearly, the unqualified will often have the highest willingness to pay since they have no legal way to obtain the service.

Incentive-based reforms in this area would involve the elimination of policies with no justification based on efficiency or distributive justice, the streamlining of other programs to limit discretion, and the introduction of legally-imposed fees to allocate scarce benefits where allocation to high bidders will not undermine program goals. Sometimes the administrative system can be reorganized to limit the monopoly power of officials and give citizens more choices.²⁴ Alternatively,

²⁴ These ideas are developed in more detail in Rose-Ackerman (1999:39-52)

corruption may arise because the government's commitments, to universal health care, for example, are inconsistent with the level of funding it provides. The state must either cut back its stated commitments or increase spending at the same time as it reform the delivery system.

b. Bribes as incentive payments for bureaucrats

Bribes can be incentive payments for good service. Firms and individuals may pay to avoid delay. Payoffs to those who manage queues can be efficient since they give officials incentives both to favor those who value their time highly and to work quickly. The corruption of tax collectors may be efficient so long as the government can impose a binding overall revenue constraint. But the conclusion that the routine corruption of those who manage queues and collect taxes can be tolerated is extremely problematic. First, the result only follows if officials have limited discretion. Second, noncorrupt alternatives exist that avoid the costs of illegal payment systems. Queues can be managed through a set of differential fees. Revenue collection offices are sometimes permitted to retain a portion of the taxes they collect.

Firms pay bribes to obtain certainty, but the certainty may be illusory since corrupt deals can not be enforced. Individualized attempts to reduce uncertainty can, at the level of society increase uncertainty and unpredictability. Ingrained corruption can also hold back state reform. Firms that have benefited from payoffs and their allies within the state apparatus will oppose reform efforts designed to make the economy more open and competitive.

In short, although bribes can sometimes be characterized as incentive payments to public officials, a policy of active tolerance is likely to be destructive of the prospects for long term reform. Payoffs that are widely viewed as acceptable should be legalized, but not all "incentive pay" schemes will actually improve bureaucratic efficiency. Instead, the civil service system of recruitment, pay and promotion may need reform to align the incentives of officials with the goals of the programs they are administering (Rsoe-Ackerman 1999: 69-88). Furthermore, law enforcement may need to be reformed to improve its deterrent effect. Too often, enforcement is used as a way to punish political opponents or is otherwise ineffective as a deterrent (ibid.: 52-58)

c. Bribes to Reduce Costs

Governments impose regulations, levy taxes, and enforce criminal laws. The economic impact of bribes paid to avoid regulations, supersede the criminal law, and lower taxes depends upon the efficiency of the underlying programs that are subject to corrupt distortions. Given an inefficient legal framework, payoffs to avoid regulations and taxes may increase efficiency. This defense of payoffs is sometimes espoused by investors in the developing world and the countries in transition. It is a pragmatic justification that grows out of frustration with the existing legal order. It attempts to justify corruption carried out to obtain benefits to which one is not legally entitled.

But individuals and firms are not only obligated to obey laws that they judge to be efficient and just. In the United States, industry's response to environmental, health, and safety rules that it finds burdensome is not generally to bribe officials or enlist the help of criminals to evade the law. Instead, firms work to change the laws in Congress, make legal campaign contributions, lobby public agencies, and bring lawsuits that challenge laws and regulations. One can complain about the importance of wealth and large corporations in American political life, but, at least, well-documented lobbying activities and campaign contributions are superior to secret bribes in maintaining democratic institutions.

Reform efforts here can involve the same kinds of programmatic and administrative reform

outlined above, but they can also involve efforts to change attitudes and to provide transparent legal routes for efforts to influence political and bureaucratic processes.

d. Payments to obtain major contracts, concessions, and privatized firms

Corrupt payments to win major contracts, concessions, and privatizing companies are generally the preserve of large businesses and high level officials. Such payoffs appear analogous to cases in which government disburses a scarce benefit, only this time the value of the benefit is valued in many million, not a few thousand dollars. In the post-socialist states the most important recent cases involve the privatization of the entire capital stock of the economy. This is a massive, ongoing effort that produced many allegations of corruption and insider deals involving high level politicians and officials.

In such cases, politically-connected officials may be effectively insulated from prosecution and can thus be less restrained in their corrupt demands than low-level bureaucrats. Second, those who obtain benefits through the bribery of low-level officials are rarely thought to behave inefficiently once the benefit is obtained. In contrast, for major deals corruption introduces uncertainties into the economic environment that may give the corrupt firm a short run orientation. There are two reasons for this. First, the firm may fear that those in power are vulnerable to overthrow because of their corruption. A new regime may not honor the old one's commitments. Second, even if the current regime remains in power, the winner may fear the imposition of arbitrary demands once investments are sunk. Competitors may be permitted to enter the market, or the contract may be voided for reasons of politics or greed.

In response to corruption in contracting, internal reforms ought to include an overhaul of the privatization and procurement processes (Rose-Ackerman 1999: 42-44,59-68). In particular, reforms should limit the influence of top politicians and their allies. Other efforts need to focus on the bribe payers, especially global firms. Some of the same firms that engage in legal political activities at home feel less constrained about violating laws on campaign funding and bribery in developing and transitional economies. Thus considerable current effort has focused on encouraging the international business community to develop norms of honesty and a lack of tolerance of bribery by their employees. In addition to efforts that are essentially hortatory, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions is in the process of ratification and includes some follow-up monitoring. A number of Central European countries have signed this treaty, and most of those have ratified it. The international movement to limit corruption in international business spearheaded by the nonprofit Transparency International is clearly an effort to change the level of honesty of global corporations.

e. Buying Judicial Decisions

Judges have power to affect the distribution of wealth through their decisions. Thus like any public official with similar powers, they face corrupt incentives. Corrupt incentives are higher when judges are underpaid and overburdened and have poorly equipped and understaffed offices. Even if judges are not themselves corrupt, clerks in charge of assigning cases and advising judges may demand or accept bribes. Payoffs can be a way to speed up decisions when delays and backlogs are high. Bribes can also influence decisions in one's favor. Occasionally bidding wars have been reported in which parties on opposing sides compete in making payoffs.

When the judiciary is viewed as corrupt, this introduces uncertainties into the business climate. The law in the books may not mean much, and those with disputes will avoid bringing them

before the courts unless they are certain to be the high bribers. Individuals with disputes find ways to circumvent the court system by hiring private arbitrators and using other methods, such as the protection provided by organized crime. In eastern Europe and Russia some murders of businessmen and bankers appear to be execution-style killing that are part of a brutal private system of “dispute resolution.” Thus reform of the judiciary can have spillover effects for the level of honesty and trust in other sectors of the economy. Thus it needs to be a priority although it cannot be done in a vacuum. If substantive laws are poorly drafted and impose arbitrary constraints, individuals and firms may avoid using the courts. If the police and prosecutors are understaffed and corrupt themselves, then the courts will be of little help in reforming the criminal justice system.

f. Buying Political Influence and Buying Votes

Democratic political system must find a way to finance political campaigns without encouraging the sale of politicians to contributors. Governments have drawn the line between legal and illegal gifts in quite different ways, and legal frameworks vary greatly in the limits they place on quid pro quo deals by politicians. This is not the place to debate the pros and cons of alternative methods of campaign finance. All I want to do here is to suggest that campaign finance legislation ought to be a priority for the new democracies in Central and Eastern Europe.

Even entirely legal contributions from wealthy interests are a source of concern. The worry is favoritism. Groups that give funds to elected officials expect help in the legislative process. They may also expect special treatment on individual problems in dealing with the bureaucracy or in seeking privatizing firms and public contracts. The electoral process can discipline politicians to represent the interests of their constituents, and voters may penalize candidates who seem too deeply beholden to special interests. But voters cannot act unless they know both how their representatives behave and who has given them money. Legal gifts can have a corrupting effect if they need not be made public and if the quid pro quo is not itself obvious to voters.

Conflicts of interest are another problem that needs to be addressed. Potential conflicts exist whenever a politician or a member of his or her family or staff has an ownership interest in a firm that does business with the government or that can benefit from state policy. No corrupt payoffs or campaign donations may occur, but the risk of favoritism is the same. Politicians may seek to benefit businesses in which they have a financial interest. Conversely, they might use their influence in a private business to further their political careers.

Self-dealing has only recently raised questions in some countries. In new democracies, conflicts of interest have not been a high priority for reformers. Yet if uncontrolled, politicians with widespread business interests can undermine governmental legitimacy as surely as those who do the bidding of large contributors. In the former socialist countries, such as Russia and Poland, the problem is particularly acute because many newly privatized firms are controlled by their former managers who often remain active in politics (Collins 1993: 326). According to one commentator, in Russia “many government officials simply do not grasp that self-enrichment while in office is a crime” (Coulloudon 1997: 73). In the Ukraine 150 businessmen and bankers were elected to the Parliament in 1998, many with economic interests that will be affected by the legislation they consider (“Ukraine’s Businessmen--A New Political Class,” *Financial Times*, April 17, 1998). Although some applaud this development as a way of assuring independence from the executive, it creates obvious conflict-of-interest problems when regulatory and tax laws are at issue.

At a minimum, disclosure of politicians’ financial interests and those of their families is

necessary for democratic accountability. Similarly, relations with lobbyists and wealthy interests should be disclosed so that voters can judge whether their representative's behavior has been affected. Direct restrictions on outside earnings and lobbying activities are more controversial, but will be most important in those political systems where the electorate is less educated and informed. Legal rules can be less restrictive the more effective are elections in assuring accountability.

The problem of money in politics is not limited to pressures on politicians. On the other side of the equation are inducements given to voters. A particularly intractable form of political corruption occurs when politicians accept illegal campaign contributions and then use them to pay off the voters on an individual basis. Voters may not object to the politicians' methods of campaign finance because they benefit from the largesse of candidates. The personalized nature of the benefits given to voters by incumbents can make it particularly difficult for credible opposition candidates to arise. The nation is nominally a democracy, but the constraints imposed on politicians' acceptance of payoffs are attenuated. Instead of a system based on democratic principles, the government is a structure of mutual favor giving that benefits those with the most resources and the most political power.

2. *Citizens as Monitors of the State*²⁵

Now let us turn from the specific causes of corruption and the accompanying sectoral reforms. Instead, consider how the public can be a check on corrupt public officials outside of the electoral process. These reforms depend upon the existence of citizens who believe that it is their duty to demand honest and trustworthy government. Martyrs and saints are always in short supply, but less altruistic people may be willing to engage in civic activities if the private costs are not too high and the promised social benefits are large.

Citizen monitoring can only operate if the government provides information on its actions. Citizens also must have a convenient means of lodging complaints and be protected against possible reprisals. Of course, government officials must also find it in their interest to respond to complaints. There are two basic routes for public pressure -- collective complaints by groups of citizens concerning general failures of government and objections raised by particular individuals against their own treatment at the hands of public authorities. Both collective and individual routes can help spur the reform of governmental structures. In this section I briefly canvass the features of an institutional environment designed to facilitate public accountability outside the ballot box. The package includes public information provision, a free media with weak libel law protection for public figures, laws that facilitate the establishment and funding of nonprofits organizations, and avenues for individual complaints.

a. *Information and Auditing*

A precondition for either type of complaint is information. People need to know what they can expect from honest officials and how to make a complaint. In many cases such informative material represents the first time ordinary citizens have ever heard that they have rights against public authority. In addition to basic information on official standards of behavior, citizen activists need more comprehensive information.

Government must tell them what it is doing by publishing consolidated budgets, revenue collections, statutes and rules, and the proceedings of legislative bodies. Financial data should be

²⁵ Derived from Rose-Ackerman (1999: 162-174)

audited and published by independent authorities such as the General Accounting Office (GAO) in the United States or the Audit Commission in Great Britain. Sometimes governments collect a good deal of information on their own operations but do not routinely make it public. In such cases statutes that give citizens a right to gain access to this information can be an important precondition for effective public oversight. These laws permit citizens to obtain government information as members of the public without showing that their own personal situation will be affected. Exceptions protect privacy, internal memorandums, and the integrity of ongoing prosecutions.

But a freedom of information act has little value if government does not gather much information. Many countries must first put information systems in order, provide for the publication of the most important documents, and assure public access to other unpublished material.

b. The Media and Public Opinion

Even a government that keeps good records and makes them available to the public may operate with impunity if no one bothers to analyze the available information -- or if analysts are afraid to raise their voices. There are three routes to accountability. If the aim is to pressure government to act in the public interest, the role of both the media and organized groups is important. If the goal is government accountability to individuals, avenues for individual complaints must be established. In all three cases -- media, groups, individuals -- there is the problem of fear. If government officials or their unofficial allies intimidate and harass those who speak out, formal structures of accountability will be meaningless.

The media can facilitate public discussion if it is privately owned and free to criticize the government without fear of reprisal. Government can also keep the press in line through advertising, printing contracts, and payments to journalists. Another subtle form of control is to overlook underpayment of taxes by editors and media companies, retaining the possibility of prosecution as a threat.

In many countries restrictive libel laws give special protections to public officials. This is just the reverse of what is needed. Politicians and other public figures should be harder to libel than private citizens, not easier. They should not be immune from facing charges of corruption, and allegations of libel should be handled as civil not criminal matters. In this at least, the United States provides an outstanding example with a law that makes it more difficult to libel public figures than private individuals and that treats libel as a civil offense. Those in the public eye have assumed the risk of public scrutiny and have access to the media to rebut accusations.

c. Private Associations and Nonprofit Organizations as Agents of Change

A free media with good access to government information is not likely to be a sufficient check. The media may focus on lurid scandals and may have no real interest in reforms that would reduce the flow of corruption stories. Individuals and groups must push for change. Individuals face a familiar free rider problem. Information may be available, but no one may have an incentive to look at it. The scandals uncovered by investigative journalists may provoke outrage, but no action.

Nonprofit organizations can fill this gap and monitor government functioning. Unfortunately, much research conflates the nonprofit sector with Robert Putnam's "civil society." This is a fundamental misunderstanding that has created considerable confusion. Putnam himself does not make this mistake, and in his discussion of social capital in the United States he goes out of his way to make clear that he is not much interested in nonprofits that survive on monetary

donations and public subsidies and that rely primarily on paid staff. His interest is in volunteering and in the process of self-governance and inter-personal interactions that for him are the generators of social capital (Putnam, 2000).

Putnam and his followers claim that volunteering in nonprofits builds trust which, in turn, builds democracy. Research using the WVS suggests caution in accepting this model. Membership in voluntary organizations played no independent role in determining the durability of democracy (Inglehart, 1997: 183, 188-194). Work by Dietlind Stolle (1998, 2001) and Eric Uslaner (2000-2001) also counsels skepticism. Stolle's survey work in Philadelphia, Berlin and Stockholm shows that the length of time spent participating in a particular organization did seem to build up "private social capital" between members of the organization. However, there was little or no spillover into general social capital as measured by generalized trust or civic engagement. In Sweden the result for some organizations was even negative. She also claims that self-selection can explain why some organizations, for example, church choirs, do seem to be composed of people who also have high levels of general social capital. Uslaner's analysis of survey work on the United States also demonstrates that membership in voluntary organizations does not contribute to generalized trust. In fact, if his results are to be believed, when one takes account of the simultaneous equation nature of the problem, involvement with church groups actually tends to decrease generalized trust although volunteering and charitable giving do have a positive influence. He also finds some degree of reverse causation. More trusting individuals are more likely to be involved in business and cultural groups and more likely to volunteer and make charitable contributions.

Accepting this skeptical view of Putnam's claims, however, does not mean that the nonprofit sector is unimportant. Putnam ignores important functions that the sector can serve in a democracy.²⁶ The nonprofit sector can play a direct role in helping to create a society where honesty and trust are the norm. Organizations with professional staff that are funded by members and wealthy donors can be of central importance in the development of an accountable democratic state and of a market economy that operates within certain standards of fair dealing. Putnam's singing clubs and bowling leagues are less important under this view than organizations such as independent schools, soup kitchens, shelters for the homeless, and environmental or human rights advocacy groups.

An NGO's role may be explicitly political or policy-oriented. It may support candidates for office or lobby for particular policies such as environmental control, consumer product safety, the prevention of drunk driving, agricultural subsidies, worker rights, oil industry tax breaks, and so on. Such groups may be grass roots membership organizations, but they are likely to need professional employees who focus on the political process. They need to raise funds from members or large donors. Citizens' initiatives at the local level operating with no national umbrella organization frequently arise in democracies, but if the issues they focus on are of widespread concern, they are likely to organize at a higher level for more effective pressure. Some groups are explicitly or implicitly associated with political parties, but many groups are non-partisan. These groups are a necessary part of democracy that can aid public accountability over and above the accountability provided by the ballot box. They are not primarily producers of generic social capital but are,

²⁶ See Rose-Ackerman (1996) and James and Rose-Ackerman (1986) for an overview of work in economics. Powell (1986) is a collection of essays on the nonprofit sector from a number of different disciplinary perspectives.

instead, direct checks on state power.

If one accepts this argument for the nonprofits as advocates and monitors of the democratic process, then the state needs to make it easy to establish formal nonprofit organizations. Some governments, worried that nongovernmental organizations (NGOs) will be used for monitoring purposes, limit such groups or make it very costly for them to organize. Formal legal constraints may be high, and members may be subject to surveillance and harassment. For example, Transparency International, an international NGO committed to fighting corruption worldwide, has found that setting up local chapters can be difficult even if local people are eager to organize a chapter. In some countries several years have passed without the chapter obtaining a formal charter. Once registered, nonprofits may face onerous formal reporting requirements.

Another problem is cooptation by the state. Some nonprofits provide services such as health care, education, and housing. Their financing may be provided by the state or by aid funds administered by the state. Thus their very existence depends upon cooperation with public authorities. As a consequence, they may be reluctant to criticize officials openly. To avoid such tensions, an NGO that takes on an anticorruption mandate should avoid participation in service delivery.

The World Values Survey found that organizational membership may contribute to democratic change.²⁷ One would like, however, to know more about how this happens. The sector's impact ought to depend upon the kinds of groups that attract members. My own hypothesis would be that policies that encourage the development of those nonprofits that interact with government can help institutionalize democracy but that nonprofits that simply build "social capital" through sports, recreation and cultural activities will not, on their own, have much impact.

d. Avenues for Individual Complaints

Fighting high level corruption requires national attention and private organizations willing to push leaders for change. In contrast, limiting low-level bureaucratic corruption is often in the interest of top officials who may try to enlist ordinary citizens in the effort. This can be done without organized citizen activity if individuals can lodge complaints easily and without fear that corrupt officials will take revenge.

Some bribes are made to get around the rules and others are made to get a benefit that should have been provided for free. Facilitating complaints will only help uncover the latter type of corruption. Bribes that permit illegal activities or that soften a legal regulation or tax assessment are unlikely to be revealed by private individuals and firms unless they have been arrested and are seeking to mitigate their punishment. In contrast, if bribery demands are a condition for obtaining a legal benefit, individuals may not go along if they can appeal to an honest forum.

Many countries have established Ombudsmen to hear complaints of all kinds, not just those related to malfeasance. These offices can help increase the accountability of government agencies to ordinary citizens. Hence they may generate a great deal of resistance from politicians and bureaucrats. Although this is regrettable, one should have modest expectations for an Ombudsman. These officials seldom uncover large scale systemic corruption and generally lack authority to initiate lawsuits.

²⁷ The list of organizations in the WVS ranges widely to include labor unions, political parties and professional associations as well as all kinds of community groups and organized nonprofits (Inglehart 1997: 396).

Some public agencies have created "hot lines" for direct citizen complaints. This method will only be successful, however, if complainants can preserve their anonymity or do not fear reprisals. "Hot lines" must be more than just symbolic. Public officials--the Ombudsman, agency oversight units, or law enforcement agents-- must follow up on complaints in a visible way. At the same time, if the complaints concern individuals, the accused must have a credible way of defending against false accusations. Otherwise, an anticorruption campaign can degenerate into a collection of private vendettas with people enlisting the state to settle their private feuds.

3. Corruption and Government Reliability

Corruption is commonly associated with untrustworthy government officials. Its underlying cause is the search for private economic gain on both sides of the transaction. It represents a betrayal of public trust. Corruption can be controlled by lowering the benefits and raising the costs of particular corrupt transactions. But it can also be controlled indirectly by limits on political power and by changes in public attitudes toward the exercise of that power. This latter strategy involves giving people and groups a way to complain about poor government service provision. To facilitate such activities, the government supplies information about its actions, the media and the public voice complaints, and private organizations and individuals push for public accountability. The goal is to increase governmental openness, leaving it more vulnerable to popular discontent. Thus many regimes, even nominally democratic ones, may view such policies with suspicion. They are, nevertheless, an essential check on corruption and on other forms of dishonest self-dealing that can arise if officials are insulated from popular oversight. One route to a more trustworthy state is the creation of institutions empowered to hold officials to account outside of criminal investigations for malfeasance.

D. Conclusion: Trust, Honesty and Corruption

The theoretical work suggests that some countries and sectors can descend into vicious cycles in which corruption, distrust, and dishonesty breed more of the same over time. Conversely, virtuous cycles can also operate in which trust and honesty build on each other. These patterns depend both on people's underlying attitudes and on calculations of self-interest broadly understood. My basic claim, based on both theory and empirical work in advanced democracies, is that attempts to produce generalized trust are not likely to produce large gains in terms of democratic performance and market functioning. Rather, the fundamental puzzle is how to create state and market institutions that are reliable and trustworthy at the same time as interpersonal relations based on mutual trust (or distrust) are kept from undermining these reform efforts. Strong and loving interpersonal bonds are, of course, valuable aspects of any society, but they can cause harm if they operate unchecked within political and bureaucratic organizations. As we will see in the sections that present data on the region, there appear to be widespread differences across the post-socialist countries in the functioning of the state and the market and in the degree of trust in public institutions and in other people. Most of the countries created out of the Soviet Union appear to suffer from much higher levels of distrust and corruption and much lower levels of functioning than many of the countries on the list for potential European Union membership. To the extent that some of the countries are caught in vicious cycles while others are not, the reform recommendations will differ widely across the region.

II. The State and the Citizen in Post-Socialist Societies

Information about honesty, trust, and corruption in post-socialist countries can be divided

into four categories: (1) trust in government and in other people, (2) individuals' perceptions of corruption in public institutions and their coping methods, (3) the role of the nonprofit sector, and (4) business dealings with each other and with state institutions. This section discusses the first two issues.

Roughly speaking, the data show a disturbing trend. The countries close to Western Europe are increasingly diverging from most of the countries of the former Soviet Union. Corruption and distrust of government are serious problems in Central Europe, and some sectors are especially dysfunctional, but, in general, the scale of the difficulties is much less than in the countries farther to the East. The evidence from some countries of former Soviet Union is that a vicious cycle may be at work where high levels of corruption, distrust and organized crime produce even higher levels in the future with a resulting undermining of state and market institutions. One important issue for future research is whether some of these countries may need to go through a second fundamental transition rather than being able to reform through small steps. In contrast, many of the countries in line for membership in the European Union appear to have problems that can be dealt with on a case by case basis.

Research on transition countries is complicated by the difficulty of knowing if the phenomena one observes are a temporary product of the transition itself or if they represent long-term attitudes and behaviors. Furthermore, we know little about whether the nature of the transition process has consequences for the type of society that will emerge. The available data cannot usually distinguish between short-term behavior and long-term shifts and has little to tell us about the feedback mechanisms that may operate to convert short-term practices into long-term characteristics for good or for ill.

There are, however, grounds for believing that the transition process has created special strains. Democratization may breed corruption and crime if it is accompanied by a weakening of state controls and confusion among the population about proper behavior in a context of increased freedom.²⁸ Similarly, especially in the transition economies, the shift from central planning to the market may lead to monetary corruption as a replacement for the system of administered benefits based on connections. The market replaces many former administrative decisions, but the state remains a source of important benefits and costs (Miller, Grødeland, and Koshechkina, 2001, Rose-Ackerman, 1994). A key issue for reformers is to identify particular sources of strain and to act to prevent transitional problems from producing major long-term distortions.

Several groups of researchers have carried out surveys in Eastern and Central Europe to assess public attitudes, beliefs, and behavior. The work considers both citizens' views of democracy and their attitudes toward and experience with public officials. The work consists of focus groups, in-depth interviews, and questionnaires. I will concentrate mostly on the questionnaires, but the results seem broadly consistent across methodologies. There are two major sources of questionnaire data. The first, "New Democracies Barometers," have been carried out by the Paul Lazerfeld Society, Vienna, and most fully analyzed by the Centre for the Study of Public Policy (CSPP) at the University of Strathclyde in Glasgow, Scotland, under its director Richard Rose. The latest survey covers eleven countries in Eastern and Central Europe. Comparable surveys

²⁸ See Verheijen and Dimitrova (1997) on the special problems facing the civil service in post-socialist countries.

have also been carried out for Russia.²⁹ The second collection of data from questionnaires, interviews and focus groups has been analyzed by William Miller, Åse B. Grødeland, and Tatyana Y. Koshechkina (2001). Most of their work is based on data gathered between the end of 1997 and early 1998 from Bulgaria, Czech Republic, Slovakia, and Ukraine. The countries were chosen to represent a range of experience with the Czech Republic and Ukraine at opposite extremes and Slovakia and Bulgaria taking up intermediate positions along an axis measuring the degree of reform. Their work focuses on corruption, but it has broader implications for understanding people's perceptions of and experience with public officials.³⁰ We know much less about the countries of Central Asia, but World Bank research on poverty, corruption, and state capture includes some material on that region (Hellman, Jones, and Kaufmann, 2000; World Bank 2000a, 2000b).

A. Citizens' Views of Government

The survey evidence indicates both positive and negative views of the new regimes. The most systematic data have been gathered countries on Central and Eastern Europe including Russia. One way to see the range of opinion is to consider answers to the "Barometer" surveys for Russia and eleven countries in transition in Europe.³¹ In 1998 these surveys showed that a large majority, usually between 70 and 90 percent, feel freer today than under the previous regime (Rose and Haerpfer, 1998a: 54-55, Rose and Shin, 1998:11-12, Rose 2000:23-24). At the low end of the spectrum are Belarus, Ukraine, and the countries created out of the former Yugoslavia, but even in those countries a summary measure indicates that a majority thinks that freedom has increased along at least three of the five dimensions considered. Of course, these answers reflect both the current situation and the repressiveness of the old regime which was relatively more open in the former Yugoslavia compared with other East Bloc countries. Thus Romania experienced the largest changes in freedom although few observers would characterize it as most free relative to other countries in the region.³²

²⁹ More information is available at <http://www.cspp.strath.ac.uk>.

³⁰ Their most recent work, along with other related survey work, and most of the underlying data are available at: http://www.nobribes.org/rc_main.shtml, a web site for the Anti-Corruption Network for Transition Economies.

³¹ Russian data are from the seventh New Russia Barometer and consist of a nationwide samples of almost 2,000 people undertaken by VCIOM, the oldest Russian survey institute. The survey for the New Russia Barometer VII was carried out between March 5 and April 15, 1998. This is the survey used in cross-country comparison. However, two additional surveys have been carried out in Russia, VIII in December 1999 and IX in March 2000. Their results will be reported when they reflect changes in attitudes or new information obtained from newly asked questions. The fifth New Democracies Barometer survey of the Paul Lazerfeld Society in Vienna was conducted in 1998 in 12 countries, 11 post-socialist countries and Austria using a nationwide representative sample; a total of 12, 643 people were interviewed (Rose and Haerpfer 1998a:7-9, Rose and Haerpfer, 1998b: 17-19, 64-67). Both sets of data have been analyzed by Richard Rose and his colleagues at the Centre for the Study of Public Policy at the University of Strathclyde, Glasgow. The former socialist countries included in survey V are Bulgaria, Czech Republic, Slovakia, Hungary, Poland, Romania, Slovenia, Croatia, Yugoslavia, Belarus, and Ukraine.

³² Details for the New Democracies Barometer V are in Rose and Haerpfer, 1998a:55-58. The relevant questions concerned freedom of speech, freedom to join organizations, freedom to travel, freedom to be involved in politics or not, and religious freedom. The question on which there was the most cross-country variation concerned freedom to travel and live where one wants. Fifty-one per cent of people in Yugoslavia. 23% in Ukraine, 14% in Belarus, and 13% in Croatia thought that things were worse along this dimension compared with single digit responses elsewhere (0% in Poland to 8% in Slovenia). For the other four questions those saying that the present situation was

In spite of their perception of increased freedom, citizens are critical of the process of transition and of state institutions and officials. They are skeptical about their ability to influence government decisions compared to the old regime. Forty-five percent of Russians and 46% of people in the other countries surveyed say there is no difference between regimes on this score. The contrast between Russian and Central Europe shows up when people are asked to compare the present with the communist past. In the New Democracies study 33% think their influence has increased compared with 20% who think it has decreased. The Russians are much more alienated with only 9% believing that their influence has increased and 46% saying it has decreased.³³

More evidence of citizens' skepticism comes from a survey by William Miller and his associates. They asked who had benefitted most from the transition. Few claimed that ordinary people were the primary beneficiaries. The Czechs and Slovaks were particularly likely to single out politicians and officials while the Bulgarians and the Ukrainians emphasized the mafia. A majority believe that politicians behaved worse at present than under Communism, and a somewhat smaller number felt the same about the officials that they interact with on a day-to-day basis. Only in Bulgaria did a majority see improvements (Miller, Grødehånd, and Koshechkina 2001:56).

To gain a fuller understanding of the situation in the post-Communist countries one needs to go "beyond the traditional focus on citizens' trust in the government in general, ... [to study] the causes and consequences of citizens' trust in specific political actors, organizations, or institutions (Levi and Stoker, 2000:498-499)." Unfortunately, the New Democracies Barometers and the New Russia Barometer simply ask people about their trust in various institutions without checking to be sure that trust means the same thing to individuals in different countries.³⁴ Nevertheless, whatever their weaknesses, these survey do provide suggestive data on public attitudes.

The Barometer surveys indicate widespread skepticism about the trustworthiness of a range of different professions and institutions both state and non-state. The list includes both major public institutions such as "parliament" and "the president" and other groups with which the average citizen will have had direct dealings such as the police and trade unions. People were asked to rank institutions on a scale of 1 to 7 with 1 representing great distrust and 7 great trust. Thus the neutral level is 4. Putting the 1998 answers from the New Democracies Barometer V and the Russian Barometer VII together one sees some variation across countries and institutions (political parties are at the low end everywhere and the military is at the high end), but, in general, most institutions are below the median score (Table 1). About a quarter of the citizens in the survey were neutral with a third expressing trust in institutions and less than one-half in the distrusting category (Mishler and Rose, 1998: 13, 33; Rose and Haerpfer, 1998a: 59-63; an earlier survey is analyzed in Mishler and Rose, 1997:422-427). Especially in Ukraine and Russia, a vicious cycle may be a real risk in which distrust breeds more distrust, but that the ultimate outcome is by no means certain.

worse never rose above single digits in any country.

³³ In the 2000 Russian survey 52% think their influence has stayed the same while 19% think it has increased and 28% think it has decreased (Rose, 2000:23). Thus there has been a fairly marked shift in favor of a belief in political empowerment. Once again, democratizing countries with more repressive old regimes show the biggest perceived improvement with 45% of Bulgarians and 61% of Romania seeing an improvement. The sense of stasis is highest for the former parts of the Soviet Union (Rose and Haerpfer, 1998a:56, Rose and Shin, 1998:19, Rose, 2000: 23).

³⁴ Levi and Stoker (2000: 499) criticize the New Democracies Barometers analyzed by Richard Rose and his associates in this regard.

Ukrainians and Russians express the lowest level of trust in political parties, the parliament and the president among the nations surveyed. They are also particularly distrustful of private enterprise and trade unions.

Table 1 here

However, some observers claim that trust in institutions is low in the United States and Western Europe as well. In the United States trust in the federal government has fluctuated since 1958, but the overall trend is downward. Trust in government peaked at about 75% in 1966 and reached a low of 20% in 1995. In 1999 it stood at about 40% (Levi and Stoker 2000: 478). Secular declines in trust in government have been found for Sweden and Britain, but this is not true of all other countries in the EU (Levi and Stoker 2000: 482-483, Rothstein, 2000). In spite of these declines, trust in particular political and social institutions was much higher in Western Europe than in Eastern Europe except for the military, and interpersonal trust was much lower in the post-Communist countries (Inglehart and Baker, 2000: 34-35; Mishler and Rose, 1997:428-429).³⁵

The Barometer surveys also asked whether people expected to be treated fairly by specific types of public and private officials. It is instructive to compare the results for Czech Republic with those for Ukraine and Russia. Table 2 shows the striking differences across countries although the results are difficult to interpret because it is not obvious that "fair treatment" has the same meaning in different countries. Notice that Russians view banks as much worse than the police and have about the same view of local groceries as they do of the police. The police are a particular problem for Ukrainians. A large majority of Czechs expect to be treated fairly by all the institutions in the survey. One would like to be able to compare expectations of fairness with "trust" in these institutions as indicated in table 1, but unfortunately, the survey does not permit this except for the police. Other research, however, suggests that those with expectations of fair treatment have a relatively high degree of trust in government.³⁶ Focusing on the police, the Czechs, who mostly expect fair treatment by the police, are much more trusting of them than Russians and Ukrainians. Notice, however, that in all countries there are people who do not trust the police but still think they will probably be treated fairly by them. At a minimum, the proportion in that category is 30% in the Czech Republic, 13% in Ukraine, and 27% in Russia. One wonders what this combination of replies indicates. Are these people who distrust the police but use a combination of corruption, connections and persuasion to get what they need? It would be worthwhile to try to understand in concrete terms what it means when people claim to distrust an institution that they expect to treat them fairly.

Table 2 here

B. Coping Strategies

Part of the transition to democracy ought to be a change in the way citizens react to poor treatment by public officials. People should begin to see government as having obligations to citizens and should become more willing to complain if treated poorly. In the 1998 Barometer survey, four-fifths of Czechs and three-quarters of Russians and Ukrainians do not wait passively. Their responses vary. Czechs are inclined to turn to the market or push bureaucrats hard. Russians

³⁵ When Austria was compared with the Czech Republic, Hungary, Poland and Slovenia in 1998, the most striking differences were the much higher levels of trust in the courts and the police in Austria and Austrians greater distrust of the media (Rose and Haerpfer 1998a: 92-93).

³⁶ Miller, Grødeland, and Koshechkina (2001:90).

and Ukrainians are more likely to pay a bribe or use connections (Table 3)(Rose and Haerpfer, 1998a: 96). The focus groups conducted by Miller, Grødeland, and Koshechkina (2001:93-132) provide a similar picture although they do not include the option of market purchase. Some citizens in all three countries are willing to use legal methods to obtain what they need from the public sector.

Table 3 here

Ordinary people view corruption as a continuing problem. In Russia 74 percent think corruption among national government officials is worse now than under communism. In Ukraine the number is 87% and in Central and Eastern Europe 71% held this view. In Poland and Slovenia 52% and 58% thought that corruption had increased. Notice that these are also the two countries where GDP in 1997 had surpassed 1990 levels (Rose and Haerpfer 1998a: 32-33, Rose and Shin, 1998:11-13). In general, there is a rough negative correlation across countries between the proportion of those surveyed who think that corruption has increased and the share who expect to be treated fairly by officials.³⁷ These responses indicate both that the countries in the former Soviet Union suffer from the most serious problems of corruption and government functioning but that the rest of the former East Bloc should not be complacent.

Most people view corruption negatively even in countries where it is widespread. In the four countries studied by Miller, Grødeland, and Koshechkina, nearly 60% view corruption as bad for the country (69% in the Czech Republic) with the rest believing it is bad for the country but unavoidable.³⁸ However, answers to a related question indicate a sharp regional divergence. The Czechs and the Slovaks generally disapprove of a system where officials sometimes accept presents and favors (91% and 81%) while 59% and 52% of Bulgarians and Ukrainians feel this way (Miller, Grødeland, and Koshechkina, 1998). This difference may reflect underlying “cultural” differences, but it could just as well indicate citizens’ beliefs about the quality of government. People may prefer a more “flexible” system of official behavior if they see the underlying rules as restrictive, arbitrary and unclear. However, people do recognize that systemic corruption can encourage

³⁷ The one exception is Romania where 66% report that corruption has increased; yet 66% expect to be treated fairly. The data are from Rose and Haerpfer 1998a: 57, 58, questions 25g, 26.

In another 1998 survey, however, over two-thirds thought most officials were corrupt. The countries surveyed were Slovenia, 79%; Poland, 69%; Bulgaria, 67%; Hungary, 67%. These attitudes were comparable to estimates for Italy and France but much higher than in Germany (36%) and Britain (35%) (Smeltz and Sweeney, 1999: 1-2). These two surveys would only be consistent if Communist officials in Poland and Slovenia were more corrupt (or were perceived to be more corrupt) than those in the other Central European countries.

³⁸ Not surprisingly, when people are asked to report their actual experience as bribe payers, the numbers are relatively low: 25% reported offering money or an expensive present. For small presents the highest proportions were reported for Slovakia followed by Ukraine. In the Ukraine 24% confessed to offering money or an expensive present (Miller, Grødeland, and Koshechkina, June, 1999a, table 2). See also Smeltz and Sweeney where most said bribing was never justified, but many said they would pay if asked. However, the per cent admitting to making payments was much smaller in all countries (Smeltz and Sweeney, 1999: 8-10).

Country:	Bulg.	Czech Rep.	Hung.	Pol.	Rom.	Slovakia
Per cent saying:						
Bribery never justified	86	81	84	86	85	75
Would pay if asked	22	22	39	33	35	33
Have paid in past 10 years	9	6	22	12	14	16

officials to create problems which they then offer to solve in return for a payoff.³⁹ The flexible application of rules may be producing incentives for officials to create unnecessary problems.

In dealing with public officials, people presumably use strategies that they think will work. However, some seem to be disappointed. The Czechs are more likely than the Ukrainians to succeed in getting what they want when they argue or persist, and bribery and contacts have a higher success rate in the Czech Republic as well. In Ukraine persisting and arguing are only effective about half the time and are much less effective than bribery and contacts (Miller, Grødeland, and Koshechkina 1997: 618, table 11). The data suggest that all forms of coping except appeals are more effective in the Czech Republic than in Ukraine. Nevertheless, in spite of the greater perceived effectiveness of bribery, bribery is lower in the Czech Republic than in either Russia or Ukraine perhaps because a majority expect fair treatment from public officials and have more effective options in particular cases.

To provide more understanding of citizen/official interactions one would like to know what kinds of benefits are obtained with bribes and contacts. One survey of four countries found widespread use of both connections and small presents in all four countries studied. The main differences were for "offering money or an expensive present". The overall percentages reporting that presents or illicit monetary payments are common are much lower in the Czech Republic than in Slovakia, Bulgaria and Ukraine. In all countries officials in state ministries, hospital doctors, and customs officials are near the top of the list (Table 4).⁴⁰ The variation both across countries and within countries suggests that research might focus on the institutional structures and incentives in different countries and sectors in an effort to explain the variation (Miller, Grødeland, and Koshechkina 1998b). For example, Miller, Grødeland, and Koshechkina (1998b) point out that the incentives for malfeasance in health care are very different in the Czech Republic which has an insurance-based system compared with the other countries studied.

Table 4 here

Miller, Grødeland, and Koshechkina (1997:617, table 10) divide government-provided benefits into rights and favors. The use of bribes and contacts was much more prevalent when a person wanted a favor compared to a right (e.g. at the extremes, the numbers are 57% to 28% in the Czech Republic and 94% to 36% in Ukraine). Similarly, presents and bribes were more often given before service was delivered and more often described as extorted in Ukraine and Bulgaria compared to the Czech Republic and Slovakia (Miller, Grødeland, and Koshechkina, 1998: 666, table 3, see also Miller, Grødeland, and Koshechkina, June, 1999b). The in-depth interviews suggest the way even small presents can move from expressions of gratitude to *quid pro quos*. One interviewee objected to the arbitrary nature of bribe requests and to the uncertainty about what one was buying. For health care, she argued there should be published price lists.

In spite of widespread condemnation of the systemic nature of corruption, at least half of all interviewees stated that people would most likely feel happy if they get what they wanted as a result of bribery. This feeling, however, is apparently dependent upon the belief that others are doing the

³⁹In Ukraine 42% thought this happened at least sometimes. The numbers for Bulgaria, Slovakia, and the Czech Republic are 24%, 30%, and 19% (Miller, Grødeland, and Koshechkina, 1998).

⁴⁰ Similar results are reported in a survey of a somewhat larger group of countries although cross-country rankings differ. In this study, the corruption of hospitals and doctors is viewed as especially widespread in Hungary and Poland and that corruption in universities is a special problem in Poland and Slovakia (Smeltz and Sweeney 1999: 4-5)

same thing. When asked to consider a case in which few others give, the proportion reporting that people would feel happy drops drastically and the numbers feeling angry, worried, or ashamed jumps up (Table 5) (Miller, Grødeland, and Koshechkina, 1998). Any of these attitudes could lay the groundwork for reform. Angry people may complain; worried ones may stop making payoffs from fear of being caught, and those who are ashamed may also refuse to pay in the future. Ukraine is no different from the other countries in this regard, an encouraging finding for reformers.

Table 5 here

The authors end their analysis of corruption with a multi-variate analysis demonstrating that extortionary officials have a powerful independent influence on bribe-giving. The effect of an individual's condemnation of bribery on actual behavior declined slowly from the Czech Republic through Slovakia and Bulgaria with a sharp drop for Ukraine where the impact was negligible (Miller, Grødeland, and Koshechkina, 1998). In all four countries, public opinion is against corruption. However, corruption is maintained both by officials who create problems and ask for payments to resolve them and by citizens who are willing to seek individualized benefits because it helps them function in society and because they do not think that others will condemn them since they are also involved. This self-sustaining system seems most entrenched in Ukraine and in some service areas in the other countries, such as customs and medical care. The inter-sectoral variation in the Czech Republic and Slovakia, however, provides encouragement to those who would emphasize the role of opportunities and expectations in limiting both corruption and the use of insider contacts. It suggests that there are no deep cultural barriers to reform, but that change will accompany reforms in the service delivery system and in people's realistic expectations of the behavior of others. These results are consistent with Margaret Levi's model of "contingent consent" discussed above (Levi 1997:16-30). Unfortunately, some of the countries in Central and Eastern Europe appear to be in a trap where widespread non-compliance and lack of government credibility create self-reinforcing patterns of behavior in spite of people's expressions of distaste for the present situation.

Similar self-reinforcing patterns of behavior can operate on public officials as well. There have been few attempts to determine the attitudes of officials, but one study is suggestive. The Glasgow researchers interviewed 600 officials in health services, education, welfare, police, and legal services (Miller, Grødeland, and Koshechkina, 1999a). Officials' reports of being offered "a small present" or "money or an expensive present" are consistent with the country-by-country results of the citizen interviews. Thirty percent of officials confessed to being offered a small present, and 10% reported being offered money or an expensive present. Officials were almost evenly divided between agreeing that the receipt of money or an expensive present was a corrupt practice that should be stopped and a belief that such practices were a way of improving the pay of officials. Once again, however, Ukraine is an outlier with only 36% condemning the practice. In the entire sample, 60% thought that accepting something for extra work was justified, and over half felt this way about providing expedited service (Miller, Grødeland, and Koshechkina, 1999a).

The corruption problem seems not to be a direct result of officials who are holdovers from the communist era since there was no systematic difference between officials with or without a career in the previous government or between officials with alternative ideologies. The only attitude with any explanatory power was a disposition to obey the law even if it seems unreasonable. Low pay and job insecurity were associated with corruption, and the incidence of corruption was

negatively associated with officials' expectation of a penalty. Institutional or job-related characteristics were important—a result consistent with the interviews with citizens (table 6). There were sharp differences not only across the five categories of public service provision but also within occupational categories. The authors explain these differences on the basis of both power and opportunity. Thus most doctors and nurses accepted small gifts, but doctors were more likely to report accepting large gifts. Traffic police were much more likely to report accepting gifts than other police. Multiple regression analysis confirmed these findings. Cross-country differences affected the willingness to accept bribes. Over and above these differences, however, were occupational variables. In the statistical work, hospital doctors, customs officials and traffic police stood out as especially prone to corruption because of both opportunities and temptations. Institutional conditions have an impact through personal culture and fear of punishment (Miller, Grødeland, and Koshechkina, 1999).

Table 6 here

The consequences of corruption in public services, especially education and health, are beginning to have negative consequences for the poor especially in the countries of the former Soviet Union. There is a trend to de facto privatization of some services that, without any compensating subsidies for the poor is reducing their options. According to the World Bank, under-the-table payments to teachers are jeopardizing universal school enrollment in some of the poorest countries. Of course, poverty itself encourages families to keep children at home as income earners, but the need for payoffs is an added incentive (World Bank 2000b: 42-43, 236). As indicated by some of the survey work described above, corruption also sometimes undermines university entrance exams and admission to prestigious departments (ibid.: 46-47, 236). For health care as well, payoff demands mean that the poor are badly served and that illness can further impoverish families. World Bank sponsored surveys of ten countries between 1996 and 1999 found that "informal payments" were common and are on the rise (ibid.: 47, 262-266). The share was above two-thirds such countries as Russia (74%), Azerbaijan (78%), Poland (78%). As the World Bank notes, this result "reflects a collapsed public system that is now financed on a fee-for-service basis" (ibid: 264). The privatization of land and the distribution of pensions and social benefits sometimes involve corruption and favoritism, and the poorest households are usually the ones that lose out. The World Bank provides examples of the former from Armenia, Moldova, and Kazakhstan and of the latter from Kyrgyz Republic and Georgia (ibid.: 44-46). Police corruption also means that law enforcement services are biased toward those willing pay. Surveys of the poor in Bulgaria, Georgia, and Moldova frequently produced complaints about police corruption (ibid: 47-48). In short, the widespread corruption of government service provision has a particularly harmful effect on the poor and appears to be contributing to the population's disaffection with and distrust of the political regimes in some of the post-socialist countries.

C. Time Trends and the Burden of the Past

By 1999 only Poland and Slovenia had levels of Gross Domestic Product (GDP) which exceeded 1989 levels. Slovakia and Hungary were at 1989 levels with the Czech Republic close behind (European Bank for Reconstruction and Development, 2000:65). The declines are especially dramatic in the countries in the former Soviet Union. Thus even 1998 survey questions concerning politics and government will likely reflect the fact that the standard of living of many people remains below its level at the time of the change in regime. Furthermore, the post-socialist countries are

experiencing a growth in income inequality. Skepticism should be expected.

Between the first New Democracies Barometer in 1991 and the 1998 survey the share expressing approval of the former communist regime has crept upward everywhere except in Poland although the absolute levels are, of course, widely different. A similar result holds for approval of the current regime and predictions about the future (Rose and Haerpfer 1998b: 27-31).⁴¹ However, between 1993-1994 and 1998, levels of skepticism and distrust in particular institutions did not change much.⁴² The Czech are distinctive in that trust in all political institutions has fallen over the period. Thus even countries close to Western Europe with fairly well-established markets and governments need to be aware of the potential fragility of their systems.

In surveys, people do not generally blame the Communist past for current problems. In particular, the current high level of corruption in society is generally viewed either as part of the moral crisis of transition or as a result of the country's culture (Miller, Grødeland, and Koshechkina, 1998). Current perceptions of the impact of the prior regime may not be the whole story, however. As Piotr Sztompka (1999:152-160) argues, today's citizens of the countries of Eastern and Central Europe grew up under the "bloc culture" of the socialist system, an experience that eroded trust in public institutions and may have contributed to the high levels of corruption during the transition. Sztompka argues that during the socialist period people segmented their lives into the public and the private with the former seen as "bad" and the latter as "good." There was a generalized distrust of any information originating with the public authorities, and authorities were viewed as alien, hostile, and not to be trusted.

Research on Poland in the seventies found that people praised those who "beat the system" even by illegal or illicit means (id.: 156). Sztompka characterizes the Solidarity movement as an attempt to create a political movement using the rhetoric of family, based on strong interpersonal ties and mutual trust based on bonds that were nationalistic, religious, and rooted in working class solidarity. The regime was the object of distrust (id.:157-158). A survey in 1988 found that 88% blamed economic and social problems on "bribery, corruption and abuse of power for private benefits" (cited by Sztompka, 1999:159). Two years later, when the first democratic government took power, there was both horizontal trust among people and vertical trust of the Solidarity-led government. This temporary surge of trust in government, however, broke down as economic conditions deteriorated. Distrust in state authorities reappeared and grew over time (id: 159-160). In short, although Poland went through a short post-revolutionary period of trust in government, the reemergence of distrust in authorities and the perception of widespread corruption may be a function not only of economic hardship but also of people's past experience with government under communist rule.

Most countries in transition are still suffering economic hardship and negative or static

⁴¹ These data are not based on panel surveys but represent different samples. Very little work on political trust has been based on panel data (Levi and Stoker 2000: 501).

⁴² Extending the survey period to 2000 in Russia, a similar result holds (Rose 1999b:20-21, Rose 2000a: 32-33, Rose 2000b:28-29). The most striking changes were in citizens' views of the president, a question that is a de facto approval rating for a particular person not an institution. For example, in Russia trust in the president went from 33% in 1993 to a low of 12% in 1996 to 49% in 2000 after Vladimir Putin's election. There were also relatively large shifts in favor of the parliament in Bulgaria and, oddly, Belarus. Calculated from table 4 in Rose, Mishler, and Haerpfer (1997: 17) and table A in Mishler and Rose (1998:33)

growth rates so it may be too early to measure trends except in those countries where negative spirals are under way in which high levels of corruption and distrust breed even higher levels in the next period. Poland, however, has begun to experience positive growth rates in national income, and although not all sectors of society have benefited, it can be used as a laboratory to examine the interaction between trust in government and economic prosperity. Sztompka reports survey results for the 1990's. In 1992, 86% of respondents defined corruption as a very grave social problem, and 54% claimed that giving bribes was the only effective way to deal with the administration, even in simple and uncomplicated cases (CBOS Bulletin, April 1992, reported by Sztompka, 1999: 161). Corruption was seen as most pervasive in administration and public institutions (44%), courts and judiciary (41%), and police (39%) (CBOS Bulletin No. 5/1994, reported by Sztompka, 1999: 161-162). With some internal variation, trust in the parliament, in government, in the Church, and in the president fell from the end of 1989 to mid-1993. In 1993 surveys, 87% of a nationwide sample believed that politicians neglect the public good, and 77% believe they use their offices for private profit., 48% believed that the public administration was permeated by corruption.

A number of other surveys taken during this period reported widespread criticisms of the reform process in both its political and its economic aspects (id: 1999: 166-171). In 1993 many people focused on the dark side of reform. Thus 93% cited the growth of crime, 89% mentioned economic rackets, 87% noted socio-economic disparities and the growing polarization into rich and poor, 57% mentioned reduced social security and care for the needy, and 62% weakened mutual sympathy and helping attitudes among people (GW, June 17, 1994 cited by Sztompka, 1999: 167). Distrust in government went along with distrust in other people. The belief that "most people can be trusted" fell from 10.1% in 1992 to 8.3% in 1993. Similarly, the share saying that "one can never be careful enough in dealing with other people" was supported by 87.8% in 1992 and 90.3% in 1993 (Sztompka 1999: 170).⁴³ Sztompka argues that these results are based on a mixture of actual experience and psychological attitudes. They reflect the high level of uncertainty, insecurity, ambiguity, and opaqueness of the post-communist world, the ineffectiveness and weakness of public authorities, and the decline in living standards experienced by many households. The impact of these factors was exacerbated by the high expectations of the post-revolutionary period (id.: 174-179).

As Sztompka notes (id: 179), at the end of 1993 one could interpret the Polish situation pessimistically as one where distrust was breeding even more distrust producing a spiral of cynicism, cheating, and law evasion. Yet according to his reports of more recent work, this is not what happened. Polish society seems to have turned a corner. Sztompka reports that in the second half of the nineties levels of trust in parliament, government, the President, and the Church have risen and maintained themselves at quite high levels (id: 180-183). Support for democracy has risen from 32% in 1993 to 72% in 1998. In recent surveys more people report that they are better off than the year before and that they expect to be better off in the coming year (Sztompka, 1999: 180-181, see also Rose and Haerpfer, 1998b: 46-49). Sztompka explains the shift in attitudes as arising from six factors. They are the perceived irreversibility of the transition, the consolidation of democracy and constitutionalism, the consolidation of the market and private property accompanying a surge in economic growth, inclusion in Western European institutions such as

⁴³ In the United States in the nineties the per cent saying that most people can be trusted was about 35%, down from about 55% in the sixties (Uslaner 2000-2001).

NATO, the growth in civil society and an educated middle class, and generational turnover (Sztompka, 1999: 185-190).

Some of the results from the New Democracies Barometer, however, suggest that Sztompka's report on trends may be too optimistic. According to those surveys, there has been a falling off in expressions of support for the current situation and in optimism about the future. Table 7 shows the results for Poland for a number of questions and compares it to the mean for countries surveyed in Central and Eastern Europe (CEE).⁴⁴ The Poles are generally more positive about both economic conditions and democracy than the mean of the CEE, but most political measures have worsened since 1995. Even citizens' views of general economic conditions have worsened since 1995 although the share satisfied with their own family's economic situation has risen over the entire period of the surveys. The most dramatic affirmative change in Poland was a sharp drop in the per cent who expect a suspension of Parliament to 10% down from 53% in 1993. However, this finding must be tempered by the fact that until 1995, the Poles thought that a parliamentary suspension was much more likely than the mean for the CEE countries (Rose and Haerpfer, 1998b). The bottom half of table 7 reports the proportion of those surveyed for 1993, 1995 and 1998 who expressed some trust in each of several different types of institutions. The table compares Poland with the reference group of CEE countries. The level of trust in political institutions is no better than in the region as a whole and has not improved over time except for trust in the president (Mishler and Rose, 1998). In short, even in Poland, the survey results are not all rosy. One would like to know, however, if the recent declines in approval for the current regime reflect overall disillusionment or simply growing political sophistication indicating a greater willingness to challenge the regime and demand accountability (cf. Hardin, 1999). Do the numbers represent disillusionment that may lead to apathy, or do they represent a realism about politics that may produce more active grassroots reform efforts?

Table 7

D. Conclusions

As economic conditions in some of the countries in Central Europe improve, there appear to be sectors of the economy, especially some government services, that have lagged behind and may even have deteriorated. Public services such as health care and a university education that are provided below cost by governments may be subject to higher corrupt pressures in the future as those with money seek favorable treatment. One danger sign is a World Bank survey showing that 78% of Polish patients made informal payments for care in 1998 (World Bank 2000b: 264). The problem of poor and corruptly provided public services is likely to be a growing problem in most of the transition economies even if GDP per capita rises above pre-reform levels. An important on-going issue in the transition economies is to be sure that sectors under heavy state control do not become de facto privatized through corruption and self-dealing. The response might be de jure privatization, but if issues of distributive justice, market failure, and fairness are involved, the state will not be able to exit entirely from sectors such as health care and higher education but will have to organize the delivery of services to provide social safety nets and assure broad access.

Overall, the survey results suggest two major policy issues that need better documentation and analysis. The first is the generally lower levels of trust and higher levels of perceived corruption

⁴⁴ The countries are Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia, and Slovenia.

as one moves east across the region. These results suggest that some countries are experiencing high levels of government failure and are in danger of spiraling downward to lower levels of government performance and economic growth.⁴⁵ Second, even in countries that have escaped such pathologies there are worrying suggestions of disillusionment. In particular, as economic prosperity improves, it is important for the states in Central Europe to reform lagging sectors such as health care, infrastructure and the operation of the regulatory and tax collection bureaucracy.

III. Trust and the Nonprofit Sector

Some claim that the problems of the transition to democracy and the market are rooted in low levels of generalized trust in other people and that one solution to this problem is the development of a stronger civil society in which people interact with each other to carry out common goals. In the first section of this paper, I expressed skepticism about both parts of this argument. On the one hand, although generalized trust and democracy are correlated, no one has demonstrated that the causation runs from trust to democracy. On the other hand, even if generalized trust helps institutionalize democracy, membership in voluntary organizations has not been shown to produce such attitudes. However, even if these claims are false, there is good reason to facilitate the development of nonprofit organizations for more straightforward reasons. They can provide services, and they can be advocates and gadflies. One way to encourage the development of a more trustworthy and a less corrupt state is to have an active civil society, distinct from political parties, that is willing to hold state actors to account.

In Central Europe the nonprofit sector is reemerging after a period of suppression. Under socialism, there were few voluntary or civic associations, and those that existed served state functions. However, near the end of the socialist period some independent organizations existed in Hungary, Poland, the Soviet Union, and East Germany (Marschall 1990, Sztompka, 1999:151-160). State-sanctioned "voluntary" organizations during the socialist period were concentrated in the areas of sports, vacation resorts, and culture. In most countries, government-approved labor unions and professional associations existed but had little independent power (Salamon et al. 1999: 283-370). In the region, the voluntary sector is weak especially in the former Soviet Union. A history of cynicism and alienation from politics continues to limit the development of civic organizations (World Bank 2000b:198) although this legacy may be weakening in some of the more advanced reformers.

The best current information comes from the Johns Hopkins University Nonprofit Sector Project directed by Lester M. Salamon. which has gathered data on the Czech Republic, Hungary, Poland, Romania, and Slovakia.⁴⁶ The Hopkins project concentrates on the formal, organized nonprofit sector and includes data on service delivery organizations such as schools and hospitals and those that engage in civic activities and advocacy, religious congregations, and professional organizations and unions.

The sector is small in those countries where survey information is available with the share of

⁴⁵ Many countries in the Commonwealth of Independent States (CIS) are experiencing "a spectacular increase in poverty and very high inequality. With rent-seeking channels now firmly 'institutionalized,' politicians in much of the CIS are reluctant to let the process of democratization and market expansion move further, since it may jeopardize the status quo" World Bank 2000b: 108).

⁴⁶ The project lists Russia as a country to be included in future work but no information is yet available. The material on Poland is also incomplete. The project's web page is: <http://www.jhu.edu/~cnp>

employment below 2 % in 1995 compared with 7.8% in the United States and almost 5% in France and Germany (table 8). As a share of GDP, the cash expenditures of the sector range from 0.3% to 2.8% far below United States' 7.5% and the 4% shares for France and Germany. However, in many countries the sector appears to be growing and becoming more established. For Hungary, the only country in the region with data for 1990, the share of GDP increased from 1.2% to 2.8% in five years. This makes Hungary comparable to Austria's 3%. (Salamon et al., 1999: 283-370).

Table 8 here

As Salamon and his associates (1999: 283-370) point out, although the sector is growing in most countries in the region, it is not very self-conscious of itself as a collection of organizations with a special role to play in a democracy. During the transition, a number of scandals tarnished the reputation of the sector.⁴⁷ Large, state-dominated nonprofits were sometimes "privatized" by their former managers in a way that led to asset-stripping. Operating under lax financial reporting requirements, nonprofits have also been used as tax shelters (World Bank 2000b: 198). Although most of these scandals are now in the past, they have damaged the public's perception of nonprofits. The growth of the sector has been further hampered by unclear or restrictive legal environments that create red tape without establishing the basic reporting and transparency requirements needed to inspire the confidence of potential donors, clients, and customers. Thus, the weaknesses of the sector can be explained not only as a part of the legacy of socialism but also as a result of institutional and legal weaknesses that persist in the present.

Financing comes from private donations, public subsidies, and fees and charges (table 9). Like all countries, private monetary donations are not the primary source of funding. The government operates in partnership with nonprofits in many sectors, and fees and charges are a major source of revenue. Nonprofits in the Central European Countries are relatively more dependent on private philanthropy than elsewhere with the shares ranging from 14 to 26%. Volunteering appears to be relatively unimportant in the region. As a share of non-agricultural employment, it ranged from 0.3% to 1.1%, comparable to Brazil, Austria, and Japan. Because paid employment is low as well, volunteering provides a share of total nonprofit employment that is negatively correlated with its size. In Hungary, which has the largest sector, volunteers make up only 19% of full time equivalent workers (FTEs); in Romania, where the sector is very small, volunteering accounts for 57% of the FTEs. In Hungary, between 1990 and 1995, the size of the sector as a share of GDP more than doubled while volunteer labor fell from 1.5% of nonagricultural employment to 0.3%. This appears to represent an absolute decline in volunteering not just an increase in overall employment.

Table 9 here

The current mix of organizations reflects the role of "voluntary" organizations under socialism. The relatively strong emphasis on recreation and culture and on trade unions and professional organizations persists (Salamon et al., 1999:283-370). Outside of those areas, there are wide cross-country variations. The difference are partly the result of differences in state financing.

⁴⁷ For example, in Russia in early 1996 Anatolyt Chubais used a nonprofit called the Center for the Defense of Private Property as a place to accept an interest-free loan from a Bank that benefitted from a subsequent privatization. A portion of the money was reportedly eventually deposited in Chubais' s private bank account. See Fred Weir, "Robbing Russia Blind," *In These Times* 22: 21 (January 11, 1998). See also Katherine E. Young, "Growing a Democracy: Russia' s Non-Profit Sector Takes Root," *Russian Life* 39:12 (September 1996).

For example, in Hungary the state supports nonprofit development and housing agencies; in Slovakia, the state finances nonprofit educational institutions, and in the Czech Republic, government supports nonprofit cultural, recreational, education and health institutions.

In countries with strong Catholic or Protestant traditions, such as Poland and Slovakia, the church is an important catalyst although its influence is partly a result of state subsidy. The state provides 40% of church expenditures in the Czech Republic; in Slovakia the number is 24%; and in Hungary, 8%. Thus the financial ties between church and state are very different across the region although, for a fuller view, one would need to include support to religious schools, hospitals and other agencies. In the Orthodox countries the church has played little social role and concentrates on religious worship. Partly for this reason, the nonprofit sector is small and impoverished in Romania even though the state provides 49% of the church's budget (Salamon et al. 1999: 337-354). Similarly, in Russia in 1998 only 5 percent of those surveyed reported membership in a sports, recreation, musical or artistic, political, or neighborhood organizations and only 9 percent were members of any face-to-face organization. Neither labor unions nor the church were important in most people's lives.⁴⁸ This evidence suggests that a divergence may exist between Central Europe and the Former Soviet Union that echoes the differences in public attitudes summarized above.

Civic and advocacy organizations are a relatively small sector everywhere, but they receive from 40 to 55% of their funds from the public sector--figures that cast doubt on their independence as watchdogs over the exercise of state power. The corresponding figure for the United States is 5%. However, the Hopkins project combines funds from domestic government sources with those from foreign governments and aid organizations. In Romania, although public sector support accounts for 45 percent of all revenue, less than 7 percent comes from domestic governments (Salamon et al. 1999:347). Thus advocacy organizations may be more independent of domestic governments than the raw numbers indicate.

In short, the Johns Hopkins data raise a number of intriguing questions about the role of the organized nonprofit sector in developing "social capital", in service delivery, and in helping to hold government accountable to the citizens. Volunteering seems to be not so much a measure of civic engagement, as a necessity imposed by lack of funds. There are no comparisons over time except for Hungary. However, that case suggests that as the transition proceeds, one result is likely to be a growing and more well-established nonprofit sector based on government support, philanthropy, and fees. However, the role of the sector as a generator of Putnam's "social capital" is in doubt as volunteering gives way to paid work both inside and outside the sector. The importance of nonprofits as advocacy groups is also not obvious from the data because of the small size of that sub-sector and the importance of government funding. The World Bank (2000a: 44-46), however, finds some evidence that new advocacy groups are forming, particularly with respect to anti-corruption efforts. It cites the example of the People's Voice Program in Ukraine that aims to increase the accountability of local governments.

One might combine the Hopkins data on the organized nonprofit sector with household surveys. For example, the World Values Survey (WVS) in 1990 asked about membership in voluntary organizations, unpaid volunteer work in such organizations, and motivation for such work

⁴⁸ Only 4 percent attended church at least once a month, and only 8 percent trusted labor unions to represent their interests. Compare this with a similar survey in Korea after its turn to democracy in which 75 percent reported membership in face-to-face organizations (Rose and Shin, 1998: 16-18).

(V19-68, Inglehart 1997: 3976-397)⁴⁹ In general, in Central and Eastern Europe organizational membership was low compared with the United States and northern Europe and was comparable to Latin American and Southern Europe (Inglehart, 1997: 190). Of course, 1990 is too early a date to use for comparative work given the vast changes that have occurred in the region in the past decade. Because the WVS included this question in the 1996/1997 survey, however, one could examine the consistency between its surveys of households and the Hopkins' surveys of organizations. One could discover if particular types of volunteering are concentrated in particular groups in the population and match up motivations with the organizational goals of the nonprofits. Because this has not been done, there are large gaps in our understanding of the role of nonprofit organizations in the process of state-building in Central and Eastern Europe. This is an important area for future research as one tries to understand the link between public attitudes and behavior, on the one hand, and institutional structures and incentives, on the other. One needs to combine research on the development of attitudes favoring trust and honesty summarized in Part II with work on the creation of institutions that reward those who behave in trustworthy and honest ways. Cross-country differences are likely to be important with upward trends in Central Europe, little institution vitality in Central Asia, and very weak NGO sectors in Russia and Ukraine.

IV. Business Behavior in Weak Legal Environments

Business firms in Eastern and Central Europe operate in an environment where corruption and false reporting are common, legal standards are often unclear, and the judiciary is unreliable. Reciprocal trust between market actors may be needed as a substitute for one-sided trust in legal rules. However, when the law is weak, reciprocal trust may be difficult to establish outside of existing links based on kinship and history. This fact will make it difficult to establish competitive markets or even for buyers and sellers to expand their base of suppliers and customers. In extreme cases, a country can spiral into deeper and deeper economic crisis.

Once again, the problems of corruption and untrustworthy government are more serious in the former Soviet Union than elsewhere. The issue raised by the empirical work is whether some countries are experiencing problems that are different in kind from the problems of others farther to the west. I raise for discussion the possibility that Russia, Ukraine and other independent parts of the former USSR may need to go through a second economic transition that seeks to create a more law bound economic system that emphasizes the creation of well-functioning competitive markets.

Survey research sheds light both on the relationship between firms and on the relationship between firms and the state. Evidence from a 1997 survey of five countries in the region has been analyzed by Simon Johnson, John McMillan, and Christopher Woodruff. They study the way law and the courts affect investment and contractual behavior, and they analyze the association between dishonesty in the sense of false reporting and the payment of bribes and protection money. The

⁴⁹ The types of groups listed are: social welfare services for elderly, handicapped, or deprived people; religious or church organizations; education, arts, music, or cultural activities; trade unions; political parties or groups; local community action on issues like poverty, employment, housing, racial equality; third world development or human rights; conservation, the environment ecology; professional associations; youth work; sports or recreation; women's groups; peace movement; animal rights; and voluntary organizations concerned with health. These questions were not asked in the poorest countries surveyed. Similar questions were asked in the 1996/1997 survey but have not yet been analyzed.

survey covered recently-formed manufacturing firms in Poland, Romania, Slovakia, Ukraine, and Russia. It included 300 firms in each country with between seven and 270 employees. Firms include both startups and spinoffs with the former predominating in the three Central European cases and the latter, in Russia and Ukraine.

The authors demonstrate how firms manage to cope when the legal system is weak, but they also show how a poorly-functioning legal system produces inefficiencies. Informal relationships built on trust and private sanctions cannot easily bear the entire burden of maintaining business deals, and weak states produce widespread corruption, private protection rackets, and the flouting of regulatory and tax laws.

A. Economizing on Reciprocal Trust Through Law

In the economic sphere, interpersonal trust is less necessary if the state establishes clear rules of ownership and enforces property rights and contracts. The security of property rights is affected both by the government's own actions in carrying out public policies and by the security of contractual and ownership rights. The countries of Eastern and Central Europe vary in the security of property rights, and Johnson, McMillan, and Woodruff (1999b, 2000b) ask if this variation affects investment and private sector growth. Their work complements that of those who find that weak property rights increase barriers to entry. The authors find that secure property rights are a necessary condition for new investment by established firms. Entrepreneurs with the least secure property rights invest 40% less than those with the most secure property rights.⁵⁰

The security of property rights in this research is measured by the ability of the state to enforce its own rules impartially. In other words, the benchmark is not a libertarian state but one that provides services, regulates behavior, levies taxes, and operates an impartial court system. Property rights are taken to be less secure if bribery and protection payments are common and if the courts do not enforce contracts. Thus corruption is not the route to a secure relationship with the state but opens up possibilities for extortion. Furthermore, if firms pay for protection, either to private mafias or to the police, this reduces the security of rights as well (Johnson, McMillan, and Woodruff, 2000b, Table 1). In short, a state with security of property rights is analogous to one with one-sided trust or reliability.

The trustworthiness of the state in enforcing property rights is positively correlated with reinvestment rates at the country level. This result continues to hold after controlling for other features affecting investment demand. Both a summary measure of payoffs and a measure of perceived judicial effectiveness are negative and highly significant. The statistical results are stronger for startups than for spinoffs suggesting that the managers of spinoffs may be able to use reciprocal trusting relations dating from the previous regime to overcome some of the risks of weak property rights (Johnson, McMillan, and Woodruff, 2000b). One-sided trust in the state as a reliable actor seems important. Firms appear willing to substitute legal and impartially administered taxes for the uncertainties of bribe payments and the dangers of relying on private protection services (Friedman, Johnson, Kaufmann, Zoido-Lobaton, 2000).

These results are suggestive, but, as the authors point out, they may understate the impact

⁵⁰ At the time of the survey in 1997, the absence of bank finance did not prevent firms from investing since they were profitable enough to satisfy their investment needs internally (Johnson, McMillan, and Woodruff, 2000b). Although employment growth is unrelated to property rights, high sales growth is significantly associated with more secure property rights (Johnson, McMillan, and Woodruff, 1999b).

of an untrustworthy, corruptly-administered system with weak courts because only established firms are included. In Russia a substantial “bribe tax” discourages entry (World Bank 2000b: 128, 163-164). Furthermore, as Daniel Kaufmann’s work on Ukraine demonstrates, arbitrary and corrupt governments encourage firms to stay off the books—a practice that limits their access to capital and market opportunities (Kaufmann, 1997). Investors will avoid industries especially subject to extortion, perhaps those that require large investments in fixed capital, and overall levels of investment are likely to be affected. This latter possibility is suggested by the low levels of foreign direct investment in Russia and Ukraine especially given their supply of natural resources, large internal market, and well-educated labor force.⁵¹

B. Coping Strategies

Taking the condition of the legal system and level of corruption as given, how do firms cope? Although weak property rights protections deter investment, the level is not zero and business is carried on within these weak legal environments. Johnson, McMillan and Woodruff (2000a, 1999a) and McMillan and Woodruff (2000) study these coping mechanisms and evaluate their strengths and weaknesses. In the face of a weak legal environment, developing a trustworthy reputation through repeated dealings can provide an imperfect substitute. Of course, such reputations are also important in industrialized countries with well-functioning laws and courts. In fact, one role for the law may be to facilitate the development of reputations over time by providing a backstop for private commercial dealings. Thus an important issue is whether private order is a complement or a substitute for public order. McMillan and Woodruff (2000: 31, 39) find that social networks and reputation are a substitute for effective courts, but that business networks function better when the legal system is viewed as a viable option to resolve disputes.

The evidence from Eastern and Central Europe suggests that functioning courts help firms establish new reciprocal trusting relationships. Firms were asked about their relationship with their oldest and their newest customers and with their oldest and newest suppliers. They were also asked several questions about the courts and methods of dispute resolution. Relational contracts are the dominant form of contracting. Most disputes are handled without third party intervention especially in the case of trade credit where the seller has prior information on the buyer. Reciprocal trust developed quickly. Customers pay twelve percentage points more of their bills on credit after only two months of trading. Trade associations are also helpful. Firms that belong to trade associations that offer information or arbitration services grant 4% more trade credit. Firms that believe that the courts can be used to enforce contracts have more trust in their trading partners. Entrepreneurs who say that the courts are effective grant 5% more trade credit, but the result is significant only for new relationships. Similar results obtain for suppliers. Trust in existing suppliers makes firms reluctant to shift. They will pay more to an existing supplier than to a new one. This, of course, creates barriers to entry. Reliable, trustworthy courts lower switching costs even for firms that belong to trade associations. A background institution for dispute resolution lowers transactions costs and

⁵¹ EBRD, 2000:74, 88. In Russian FDI inflows in 1999 were 0.4% of GDP or \$5 per capita. The corresponding number for Ukraine are 1.6% and \$10. Russia is the lowest of any country in the region. At the top of the list is the Czech Republic where FDI inflows were 9.2 percent of GDP and \$476 per capita. Cumulative FDI inflows into Russia between 1989 and 1999 were \$71 per capita for a total of \$10,344 million. This was a smaller total inflow than went to the Czech Republic, Hungary, and Poland, each counted separately. Of course, the per capita differences are even greater.

encourages firms to expand their range of business dealings beyond a narrow circle. In short, the courts help keep the market open to new entrants and permit trade to occur with strangers. However, over time, the business relationship is maintained by the trust that comes from repeated interactions.

There are important differences between the countries in Central Europe, on the one hand, and Russia and the Ukraine, on the other. As noted above, Central Europeans are more likely to claim that the courts can enforce contracts. However, they are more likely to report a dispute and if they have one, they are less likely to use the courts. This is so even though fewer firms are members of trade associations in Central Europe (Johnson, McMillan, and Woodruff, 2000a, table 1). A possible interpretation of this result is that the business environment is more competitive in Central Europe with a higher proportion of dealings between relative strangers. Thus more disputes arise. Because the courts function relatively well and the law is fairly clear, the norms of trade associations are less important and less definitive since they can be overturned by courts. Fewer disputes actually need to go to court because the parties can predict what the courts will decide and hence can settle their differences through negotiation. However, many more firms in Central Europe have actually used the courts than have firms in Russia and Ukraine. Only 9.3% and 13.5% of firms in Russia and Ukraine respectively have used the courts. The corresponding figures for Poland, Slovakia and Romania are 37.7%, 27.8% and 24.0%. Firms in Russia and Ukraine report few disputes, perhaps because they are spinoffs whose customers and/or suppliers are state-owned firms that provide long-term requirements contracts or because they are simply not doing much business. In fact, the average number of customers was much smaller in Ukraine and Russia (12 and 10) than in Poland, Slovakia, and Romania (100, 86, 107).⁵² Thus it appears that the Central European economies are moving toward a system in which reliable legal background norms enforced by the courts are helping to create market systems where strangers can deal with each other with an acceptable level of risk. Reciprocal trust can be created over time as former strangers begin to deal with each other. In contrast, in Ukraine and Russia the reliability of the courts and the law is low and hence economic actors are reluctant to deal with outsiders. Both buyers and sellers are locked into mutually reinforcing relationships that limit competition and entry.

C. Tensions between Contract and Loyalty

In general, an impartial, reliable legal system that sustains transactions between strangers ought to facilitate the development of a market economy. However, during the transition process there may be a downside. As McMillan and Woodruff's work on Mexico and Vietnam demonstrates, a reliable legal system ought to make entry and exist easier. Unfortunately, the possibility of exit may make it more difficult to establish trusting relationships based on repeat play (Johnson, McMillan and Woodruff, 1999a; McMillan and Woodruff, 1999a, 1999b; Woodruff, 1998; Wintrobe, 1995). Legal reform may destroy old reciprocal trusting relations more quickly than it permits new ones to arise. In the process, existing producers may suffer -- a possibility that will lead them to resist reform in the first place.

Consider a status quo where law and the courts are weak and business dealings are held together by a mixture of trust and threats. A firm lives up to its commitments because it knows that it will be very costly to find other customers or suppliers if it loses the trust of those with whom it

⁵² This result was partly a function of the smaller average size of Russian and Ukrainian firms. See Johnson, McMillan, and Woodruff (Jan 1999, Table 2) and Johnson, McMillan and Woodruff (August 1999, Appendix Table 1).

transacts. Industry groups share information about customers and suppliers in a way that gives these firms an incentive to keep their word. Because entry is limited by the cost of establishing trusting relationships, excess profits are likely to exist which will be shared by the market participants in a way that reflects their relative power. Thus a group of small firms operating through a trade association can act much like a cartel in their dealings with customers (or suppliers) –both monitoring their reputations and extracting a large share of the profits (McMillan and Woodruff, 2000: 39-45). The relative power of suppliers and customers determines the division of profits. In the extreme, one group acts like a feudal lord dealing with serfs or like a monopolist selling to many unorganized sellers. At the other extreme, both groups are equally well-organized and have equally costly outside options. Then the result is something like a bi-lateral monopoly with the added feature of private monitoring. In all cases, the constraint on both the group's monitoring ability and individual firm profitability is the possibility of customers (or suppliers) taking their business elsewhere. Weak legal protections for impersonal business relationships make exit costly. Such systems can function reasonably well, but Woodruff and McMillan's results demonstrate that they depart significantly from the competitive ideal.

In the alternative, consider a country with a reliable legal system and relatively clear rules that make arm's length contracts between strangers possible. Thus, it may not be as worthwhile for trade associations and informal groups to monitor customers and suppliers both because they can rely on the courts and because establishing a reputation within a close-knit group is not as important for survival. The "rule of law" limits monopoly profits by facilitating entry, but it may also substitute one set of transaction costs for another. Instead of informal, private monitoring based on reciprocal trust, formal legal constraints operate, and one may need to hire specialist lawyers and sacrifice a good deal of time to use the courts. In equilibrium, the "rule of law" may work well with most transactions carried out "in the shadow of the law" without actually using the court system. Nevertheless, the transition from one system to the other may well be painful and costly for incumbents who suffer not only a decline in monopoly profits, but also the obsolescence of accepted methods of monitoring performance. In the transition, the system of interpersonal monitoring may break down before the "rule-of-law" becomes established.

This possibility suggests two conclusions concerning the countries in Eastern and Central Europe. The Central European countries appear to be developing a system close to that in Western Europe where the law and the courts provide a constructive backdrop to private business dealings. In contrast, Russia and Ukraine (and Vietnam) may need to go through a second transition in which informal networks operating to both preserve monopoly profits and monitor business relationships are replaced with new legal rules and functioning courts and with business dealings that are less dependent on close, informal ties and that hence permit more competition and more access to outside sources of capital and to international markets. Entrenched reciprocal trust that maintains monopoly power may need to be replaced with one-sided trust or reliability that aided competition and helps former stranger to develop reciprocally trusting business links.

D. Business/State Relations

The final issue concerns the relationship between business and the state. The security of property rights and the viability of courts are important aspects of this relationship, but they are mainly important in setting the stage within which private economic activity can take place. State/business relations also have implications for the legitimacy and competence of government. If

the relationship is one riddled with corruption, favoritism, and dishonesty, both the state and the private business sector may be viewed with distrust by members of the public.

The broad differences in corruption and protection payments between Russia and Ukraine, on the one hand, and Central Europe, on the other, extend into the economic sphere. This is demonstrated through a range of survey results. Formally-organized firms in Russia and Ukraine are much more likely to admit to hiding sales and salaries (Johnson, Kaufmann, McMillan, and Woodruff, 2000, Table 1). Wholly off-the-books enterprises are also reported to be more common in Russia and Ukraine, and such firms hide all of their output. Furthermore, firms in Russia and Ukraine report spending more time on government and regulatory matters than elsewhere (18% and 25%, compared with about 10% for the other countries)(id.: Table 2). This may be a rough measure of the degree of extortion to which firms are subject and the degree to which firms can be exempted from rules if they curry favor with authorities. In Russia and Ukraine almost all firms report making illicit payments, and the average percentage of sales not reported is 29% for Russia and 41% for the Ukraine. In Central Europe the percent of sales not reported ranges from 5.4% to 7.4% (table 10). The cost of such services as telephone connections and licenses are provided in table 11 including estimates of non-official payments. Once again the unofficial payments are much higher in Ukraine and Russia. In Central Europe, there appears to be a group of firms that, like most firms in Russia and Ukraine, are operating both corruptly and partly off-the-books. However, one cannot tell for sure if those who hide sales are paying for protection from state enforcement or hiding to avoid having to pay bribes.

Tables 10 and 11 here.

The firms surveyed were all small and medium-sized enterprises. The managers of large firms with close links to top political leaders are not included in the sample. Such large firms may not have secure property rights in the legal sense but may be able to obtain favored treatment because of their insider status. A World Bank study calls this "state capture" and documents its importance in the transition economies. The main risk facing such firms is the risk of a change in the political leadership. The World Bank study attempted to measure the extent to which institutions of state power had been captured. Unfortunately, the survey only included the post-socialist countries. One would like to be able to compare the role of large firms in the region with their role both in the developed countries such as Western Europe and the United States and in other emerging economies. The complex relationships between economic and political concentrations of power is a major topic of research for students of democracy.

Table 12 shows how the problem of "state capture" varies across institutions and countries in the region. Thus we see that Ukraine and Russia are among the states with the worst problems and Hungary, Poland, and the Czech Republic have much better records than most other countries. There are interesting variations across countries in the institutions are most at risk--from the central bank in Kyrgyzstan to the office of the president in Latvia and Azerbaijan, to party financing in Bulgaria (Hellman, Jones, and Kaufmann, 2000; World Bank 2000a). Nevertheless, the broad outlines are consistent with the other results. The countries with high levels of "state capture" include many component parts of the former Soviet Union plus Bulgaria, Romania, Slovakia, and Croatia. There are a few cases of low capture in very poor countries with weak or non-existent democracies such as Albania, Armenia, Belarus, and Uzbekistan. Although the story may be more complex, one suspects that the low level of capture in such countries simply reflects the fact that the

institutions listed are not powerful enough to be worth the trouble or that few of those surveyed were interested in making the effort. Alternatively, survey results may, of course, be influenced by fear of reprisals especially in autocratic states. In short, these survey results can be helpful in guiding research into particular institutional failures in individual countries but can hardly be taken as a mechanical guide to locate successful reform models. They need to be combined with specific information about the institutions listed and their interaction with the private sector.

Table 12 here

E. Conclusions

A good deal of evidence suggests that countries with reliable legal systems that protect property and enforce contracts have an economic advantage. The problem in the post-socialist countries is getting from a weak system of law and untrustworthy courts to one that functions well. The countries closest to Western Europe seem in the process of establishing such systems at least for most business firms. However, Russia and Ukraine and other countries of the former Soviet Union are not at that point. Informal networks based on reciprocal trust permit trade and production, but the more established these networks become, the more difficult it may be to effectuate a transition to a modern market economy. These informal networks do not seem designed to shift easily to a world with more competitive, arms-length dealings based on trust in the rules. The countries of Central Europe and Central Asia, including Russia, may need to go through a second transition that moves them from the trap into where corruption and distrust breed more of the same and businesses take refuge in a small number of relationships with trusted suppliers and customers to the disadvantage of the larger economy. In these weak states large firms may seek to “capture” the state or conversely top politicians may “capture” leading industrialists. Then monopoly power is created and sustained by state power—a second way in which competitive markets are thwarted.

V. Research and Reform Agendas

The goal of the May workshop is to develop a research agenda for the Collegium’s project on honesty and trust. My review essay is designed to assist participants’ thinking, but the final project will obviously include other important issues and perspectives not well represented here. Nevertheless, I conclude by outlining my own interests. I do this, not to foreclose other approaches, but to stimulate discussion and in the hope that these topics will also interest some members of the group.

I identify two broad topics. First, research might seek to understand the interaction between one-sided trust based on expectations of fairness and reciprocal trust based on personal bonds. Second, corruption and its control need to be better understood as a particular aspect of how the lack of interpersonal trust can undermine attempts to create a modern state.

A. Trusting Institutions and Trusting People

Research on trust makes a useful distinction between trust in the impartiality and fairness of institutions and trust in the partiality and favoritism of one’s close friends and relations. Real trouble arises when one trusts public officials to behave like friends or kinsmen in making public decisions. Conversely, if trust in friends is generalized so that people assume the good will of strangers, a society can economize on some of the coercive apparatus of the state. Of course, the very credibility of that apparatus helps mediate interpersonal dealings. People may be more willing

to trust others if they have a backup when things go wrong.

The study of trust must bridge the gap between attitudes and beliefs, on the one hand, and behavior, on the other. Attitudes need not be constrained by exigencies of everyday life. They can reflect hopes and ideals rather than facts. When people express disappointment and distrust of political institutions, one can not tell if their expectations have outrun the government's achievements or if their expectations have remained unchanged as the institutions have deteriorated. This is a particularly difficult puzzle to resolve in the former Soviet Bloc because so many things are changing all at once both inside and outside people's heads.

This empirical difficulty complements a theoretical one. Alternative causal models can be specified that relate interpersonal trust and honesty to trust in institutions and honest dealings between officials and citizens. The causation can run from trustworthy institutions to a growth in interpersonal trust (Levi and Stoker, 2000: 493-495, Rothstein 2000), or from high levels of interpersonal trust to pressure to improve the responsiveness and trustworthiness of institutions (Putnam 2000). Of course, the world might best be modeled as a system of simultaneous equations in which both causal arrows operate. My own reading of the evidence, however, is that the line from trustworthy institutions to interpersonal trust is stronger than the reverse causation (Brehm and Rahn, 1997), but that is a contested issue which needs further work especially in the post-socialist countries. Both types of models permit a particular type of dynamic where each people's perceptions of others' attitudes and behavior affects his or her own attitudes and behavior. These interpersonal interactions can produce "good" or "bad" spirals.

First, consider the link from institutions to interpersonal trust. Suppose that most officials are corrupt and make decisions based on payoffs and favoritism. Then when people deal with each other, they do not believe that the state will provide either an objective system of dispute resolution in private law or an impartial application of the criminal law. Thus mutually-acceptable private interactions require a very high level of interpersonal trust in order to be carried out at all since there is little to fall back upon. If people start out with low levels of trust outside a narrow circle, few deals may be consummated since people have no way to communicate their trustworthiness *ex ante* in a credible way. Interpersonal trust will be very important but very scarce. Similarly, a corrupt or incompetent system of criminal law and police work will permit some people to gain economic advantages through threats and protection rackets. The extorters create an atmosphere of distrust and fear that they then use to extort payoffs. Such systems can spiral to ever worse situations as distrust in institutions breeds interpersonal distrust. The only counterweight here is the creation of exclusive reciprocal trusting networks operating inside or outside of the formal institutional framework. For example, insider groups consisting of corrupt officials and their associates may help explain why a proportion of those surveyed claimed to distrust the police as an institution but, nevertheless, to expect fair treatment. Outside groups may provide legitimate economic services, but they may also facilitate criminal activity. In the case of organized crime groups, they often do both. In either case a destructive spiral can be generated. This may be happening in Russia and Ukraine where levels of trust in institutions are low and in some of the countries in Central Asia.

Now reverse the initial conditions to ones where the public sector is largely honest and trustworthy and performs its tasks competently and in good time. With these background conditions, strangers can deal with each other confident that if they have misjudged each other, the

state will provide redress. Because people expect to be punished for untrustworthy behavior, they are likely to fulfill their promises. Similarly, the police and the criminal law reduce the risk that a private relationship will degenerate into a protection racket. Furthermore, the honesty of the public sector is maintained by the coexistence of widespread honesty combined with public expectation of honesty. Thus when people encounter corrupt demands, they are likely to report them, and law enforcement authorities are likely to be able to follow up since they are honest themselves and because they are not over-burdened. The spiral is a "good" one in which increases in the honesty of public officials and in interpersonal trust produces further increases in subsequent periods. The only risk here is a set of background enforcement conditions that people interpret as reflecting distrust in the populace. This will be a particular problem for systems where government is not reliably trustworthy or honest but that wants to jump to the favorable condition. Systems of law enforcement that in more trusting and honest societies are simply background conditions that are rarely invoked are here used extensively to establish credibility. However, the result might be to undermine the very public attitudes that the state seeks to create.

Second, consider the reverse causation from interpersonal trust to institutional accountability and competence. Suppose that people do not, in general, trust each other. Then it seems likely that they will not trust public authorities either, and vice versa if interpersonal trust is high. However, the facts for Eastern Europe suggest a more complex set of possibilities. As I reported above, in recent surveys in Russia and Ukraine levels of interpersonal trust are quite high although almost all institutions are distrusted (the exceptions in Russia are the army and the president). Conversely, in some countries with low levels of interpersonal trust such as Romania and Bulgaria, people tend to trust at least some public institutions. There does not seem to be a simple connection between interpersonal trust and institutional trust especially for institutions that are relatively remote from people's day to day life such as the military and the president. Although the World Values Survey does show that long-lasting democracies tend to have higher levels of interpersonal trust than other countries, that result cannot be given a convincing causal interpretation. Nevertheless, there may be issues worth examining further. Thus if interpersonal trust is high, that might imply that organizing people for political action is relatively easy; that is, overcoming the inevitable free-rider problems may be less costly if trust implies a willingness to listen to others and participate in political activities under the belief that others will carry their part of the burden. This could establish a causal story linking inter-personal trust to grassroots political activism to pressure for reforms in the way government does its business. Then if the first model also holds, the improvement in government performance would help fuel improvements in inter-personnel trust and so on. The only problem here is that as government becomes more trustworthy, the pressure for reform should lessen. Although the cost of organizing goes down, the incentive to do so falls as well. Thus there could be an intermediate equilibrium where the two factors are in balance.

B. The Control of Corruption

The citizens of Central and Eastern Europe are concerned about corruption and special treatment even as they engage in corrupt practices themselves. In interviews, many participants would be at least somewhat influenced by a candidate's or party's attitude toward corruption. People believe that corruption can be reduced, but that governments are not doing enough about it (Miller, Grødeland, and Koshechkina March 1998, tables 20, 23, 24). Although some see corruption

as “a permanent part of their country’s culture,” there is no particular evidence that this is true.⁵³ Thus there appears to be a broad constituency for reform. However, the research suggests a disjunction between the policies that would actually work and those that people believe will work. An implication of the interview and survey research is that corruption should be attacked by examining the institutional incentives facing officials and citizens to accept and to pay bribes. However, in interviews people emphasize stricter controls and penalties (Miller, Grødeland, and Koshechkina, 1998b, table 27), policies that are likely to be ineffective unless combined with institutional reform (Rose-Ackerman, 1999).

An strategy of emphasizing institutional reform is consistent with survey work on the importance of incentives and opportunities. Institutions can be designed to further trusting and honest behavior, but if badly designed, they can produce a spiral of distrust and corruption. In surveys people justify their corrupt behavior by citing its prevalence. However, they claim to be unhappy with high levels of corruption and report that they would feel worried, angry or ashamed if they thought they were paying when others were not. These answers suggest a opening for reform in which some services could be provided in an open and transparent manner with published prices and promises of enforcement. Too much flexibility can breed corruption and distrust, but rigid rules that are viewed as arbitrary and unfair can have the same effect. Reforms need to take account of the reality of underlying scarcities.

The survey work provides some quite specific country-by-country guidance on where to concentrate reform efforts that will affect state/society relations. The first group includes scarce services provided to the public under state subsidies where favorable individual treatment is possible. Although the level of all state-provided public services may be deteriorating, some are more subject to payoffs from citizens than others because they involve individualized benefits. Thus ordinary people may engage in only petty corruption in dealing with the transportation system since these services are essentially supplied equally to all users. In contrast, health care and university education are provided to individuals who may pay for favorable treatment. The survey work suggests that health care is an important locus of informal payments with the university system less affected except in selected countries. The fundamental reason for corruption in these sectors is likely to be the scarcity of high quality services and the failure to ration scarcity by the payment of legal prices. Of course, there are good reasons not to ration either health care or university education entirely by ability and willingness to pay, but the current system in many countries in the region appears not to have found a sustainable balance. Thus it would be valuable to carry out cross-country studies of these and other sectors to see what the widespread use of illicit payoffs indicates about the more fundamental problems of each sector.

Second, some countries, such as Russia, are suffering from such a deficit of institutional trust that even banks and local groceries are widely viewed as unfair. These are institutions where market pressures ought to produce incentives to develop a trustworthy reputation. If such a dynamic is not occurring in Russia, there are clearly fundamental organizational issues that need to be addressed that go beyond the delivery of publicly-funded services.

The third group includes government imposition of costs in the form of customs, taxes,

⁵³ Almost half Czech and Slovaks give this answer compared with 34% in Bulgaria and only 16% in Ukraine (Miller, Grødeland, and Koshechkina, March 1998, table 22). Since the former two countries are less corrupt than the latter two on most measures, one wonders just what this answer is capturing.

regulations and licenses, and law enforcement such as traffic tickets. All these sectors require diagnostic work to see if there are ways to reduce official discretion and promulgate regulations that are acceptable to those who bear the costs. For example, for taxes and customs, reform might emphasize clear, publicly-known taxes and tariffs levied on clearly articulated tax bases that are easy to measure. In addition, officials would enforce the law even-handedly and publicize collection rates so those who obey the law do not feel like suckers.

Traffic police and regulatory authorities such as building inspectors present especially difficult problems because they must interact with citizens alone on the streets or at the citizens' homes or businesses. Even if these public officials are part of a hierarchical system, they will be difficult to monitor. Furthermore, because they are imposing costs, the public may be quite satisfied with a system in which they can make payoffs to reduce costs. Many people do understand, however, that officials might create additional red tape and other difficulties in order to then ask for bribes to cut through the trouble they themselves had created. Nevertheless, at the moment when a bribe is requested, going along seems the best thing to do. Reform needs to take two different tacks. First, the laws need to be clarified, and people must be able to appeal to a low-cost and speedy institution that will accept and resolve complaints. These could include complaints by the honest about the corruption of others. Second, because many bribe payers may be quite satisfied with a corrupt system that lowers their tax and regulatory burdens, reform cannot rely only on complaints by individuals. Instead, outside monitors are needed in the form of undercover operations. Such practices, of course, have a bad name in the countries in the region, but they are central to the enforcement of anti-corruption laws in industrialized democracies and can be constrained in ways that prevent abuse.

Finally, survey evidence is biased against identifying corruption in sectors that are far from the day-to-day experience of ordinary people but that may have large public consequences. The New Democracies Barometers track public trust in government institutions such as parliaments and presidents. These responses reflect general beliefs concerning the integrity of public officials. The fact that levels of institutional trust are low even in countries where democracy seems well-established suggests a chronic problem. However, knowledge of specific examples of corruption and abuse of the public trust will depend upon what has been reported in the media and hence upon the talents and biases of reporters as well as the ownership of the media, both print and electronic. The survey evidence suggests that over half of the population does not perceive these institutions to be very trustworthy. Without a more detailed examination of the underlying political and economic situation in each country, however, one cannot know the relation between reality and perception. Thus an important topic for research is to identify the areas where corruption and malfeasance are pervasive in areas such as procurement, crime control, and international finance and aid that may be poorly perceived by the population. Reform would then involve both making this information public and seeking strategies to reduce its incidence. Perceptions of the government's honesty and trustworthiness may not be accurate.

A focus on the way institutions affect behavior leads to an emphasis on the variations in trust, corruption, and competence across sectors over and above broad countrywide differences in public attitudes and law enforcement techniques. Existing research provides hints about how to proceed, but we need much more diagnostic work. The creation of informal coping mechanisms, such as the use of trade associations or limits on customers and suppliers, needs to be understood

lest they metamorphize into structures that block further reform.⁵⁴ The non-profit sector may need legal help and advise in order to become a strong counterweight to government and private business. Criminal infiltration into government and the substitution of the mafia for government needs to be identified and resisted. Public and business attitudes need to be changed, not by exhortation, but by real changes in expectations.

The transition period in the post-Communist countries provides an opportunity to study how people and institutions react to rapid and painful change. However, the interest in inter-personal attitudes and in the development of markets and democratic government obviously goes beyond mere data gathering to a concern with facilitating reform that produces countries with viable and accountable governments, and citizens who express a sense of economic and social well-being. Sharp conflicts will remain, and cheating and crime will continue to be problems, but the hope of many citizens in these countries is to reach a point where the revolution, however "velvet" it may have been, is over, and their countries have become "normal."

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⁵⁴ The longer paper from which this paper is derived includes a section on the way businesses in post-socialist countries cope with a weak legal environment. For overviews see Johnson, McMillan, and Woodruff, 1999, 2000.

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