

**HONESTY AND TRUST:
THEORY AND EXPERIENCE IN THE LIGHT OF POST-SOCIALIST
TRANSFORMATION¹**

Research Project and Focus Group at Collegium Budapest 2001–2003

In Eastern Europe and the Former Soviet Union the transition away from a planned economy and an authoritarian state has been in progress for over ten years. Tremendous changes in the operation of the economy and the organization of the state have occurred. Yet deep problems remain. Increasingly, a split is developing between countries that are candidates for early European Union membership and other countries farther to the east. This division shows up in measures of poverty and economic growth, but it also is visible in measures of democracy, bureaucratic functioning, the rule of law, corruption, and the operation of markets. Even the most advanced countries in Eastern Europe, however, suffer from problems of political legitimacy and institutional quality. One symptom of this is low levels of honesty and trust. High levels of distrust, dishonesty and corruption affect both private relations between individuals and businesses, and relations between citizens and state officials. The project analyzes these problems and suggests solutions, recognizing that many of these issues are not unique to the transitional economies but affect all societies to varying degrees.

The Collegium brought together an interdisciplinary group to study these issues. The project included a core group of scholars who spent all or part of the fall of 2002 in residence at the Collegium and a larger group of associated scholars who participated in conferences and the preparation of papers. The goal was both to encourage new research and to develop a network of scholars with complementary interests. An innovative feature of the project is the conjunction of people working on trust as it develops in informal interactions and those concerned with the institutional bases of dishonesty and corruption. The former group of scholars has concentrated on the evolution of behavior using models that derive from game theory or evolutionary biology. The latter group studies the way institutions influence behavior drawing on work in the political-economy of regulation and government behavior. These two bodies of work have much to teach each other especially in the context of Eastern Europe where the relationships between public attitudes and political and economic institutions need to be better understood.

Countries in a transition from socialism face particular problems in developing habits of trust and honesty. Under the previous system, government institutions had become discredited in the popular understanding. Lying was acceptable and even praiseworthy in the face of illegitimate power. Trusting relationships extended little beyond one's close family and friends. The transition to the free market and democracy increased the opportunities for private gain, but the law lagged behind, and the transition failed to establish many of the informal habits and practices that supplement the law in developed countries. Many close observers of the transition process now recognize that the rush to privatize and open the market underestimated the importance of establishing legal structures for the development of a modern economy. Democratic constitutions have been established almost everywhere, but other aspects of law reform have been less prominent.

The project overlaps with the current debate over “civil society” and earlier work on the role of the nonprofit sector. The institutional challenge involves not just the reform of public bodies and the development of the for-profit sector but also the creation of voluntary associations and nonprofit

¹ Подробнее см.: <http://www.colbud.hu/honesty-trust/Description.html>.

organizations. Some claim that societies with a rich variety of voluntary associations encourage civic engagement. Others focus on citizen associations with a clear political or policy agenda that operate outside of the political party framework. In the Eastern European context one thinks of environmental, human rights, and anti-corruption groups. Thus one can ask how the development of such organization is facilitated by the societal level of trust and whether they can, in turn, help produce higher levels of cooperative activity.

In the study of transition economies one needs to distinguish between true transitional phenomena that can be expected to disappear as the new states become more established and deeper structural problems that will not necessarily evolve in a favorable direction but that need self-conscious exercises of political will. Some of the difficulties faced by the current regimes are not just temporary growing pains but represent more fundamental problems. One important research task is to determine whether public attitudes are a reflection of underlying problems or are simply a holdover from the past. Furthermore, reforms need to focus on ways to economize on trust and to overcome narrow groupings based on trusting, personal connections that control key areas of economic and social life. In other words, one needs to distinguish between trust in individuals who will favor you personally and trust in institutions that operate with fairness and openness.

This is a broad research agenda, and the project cannot cover all these issues with equal facility. Nevertheless, we have begun with a comprehensive view of the issue at the intersection between theory, empirical work, and policy. The ultimate outcome depends upon the talents and interests of the scholars we have managed to attract to the project and to the Collegium.

Organization of the Project

The project has developed from the original collaboration between János Kornai and Susan Rose-Ackerman toward the semester in residence and a conference in the fall 2002. It began with a planning workshop in May 2001 funded by the Collegium. This workshop set the terms of the project based on the interests of the participants and formed a basis for invitations to spend time at the Collegium in the fall of 2002.

The details of the particular research projects depended upon the participants' own interests and on the issues identified in the preliminary workshop. The goal was to bring to together scholars in economics, political science, psychology, sociology, law, and philosophy. Many of the participants had already been engaged in interdisciplinary work and were used to talking across interdisciplinary boundaries. Some people are experts on the region, and others have thought about how to create an environment in which trust and honesty can flourish. Professors Kornai and Rose-Ackerman, in consultation with others, had identified a strong list of potential participants from both inside and outside the region, but the final shape of the project depended upon both the level of funding and the interests of potential participants.

Summary of the Project²

The basic transition to the market and democracy has taken place in Central Europe. Elections routinely replace incumbents and occur with a minimum of fraud and controversy. Violence is limited and is not a routine feature of political life. The private sector comprises a large share of the economy, and markets are functioning fairly well. Regulatory systems may be weak and subject to corruption, but they operate with some degree of professionalism and competence. In Russia and other parts of the former Soviet Union the situation is more problematic. The outward forms of democracy and the market exist, but the institutions are still quite fragile and subject to capture by powerful interests and to criminal influence and corruption.

² By Susan Rose-Ackerman, December 23, 2002.

Even in the countries poised to enter the European Union, government officials and institutions are widely distrusted, and many are believed to be dishonest and corrupt. Informal trusting relations among individuals and firms, between these groups and public officials are common, but they may be a poor substitute for fairer or more impartial decision-making. The Project on Honesty and Trust in Post-Socialist Societies sought to shed light on these phenomena and to suggest policy responses.

The project brought together experts on the region with scholars who have worked on trust, honesty, and corruption in a broader context. The contributors were political scientists, economists, sociologists, philosophers, and legal scholars. The discussions forced the participants to communicate across disciplinary boundaries and to understand the way different disciplines approach a common set of problems.

The workshop papers concerned both vertical and horizontal honesty and trust. The former refers to the trustworthiness and reliability of public institutions and officials and the way the state is perceived by citizens and businesses. The latter concerns the relationships between people and firms operating against a background of legal rules and public institutions. These are overlapping categories. Business dealings can be affected by managers' and owners' perceptions about the effectiveness and fairness of regulatory agencies and courts. Reliable public institutions can help foster interpersonal trust and a belief in the fairness of individual rewards. A number of papers reported on the existing situation in the region.

- At the individual level, at least in Hungary, many people attribute financial success to dishonest behavior or to forces outside one's control (Antal Őrkény³). These attitudes are troubling to those seeking to institutionalize democratic governments and competitive markets based on individual initiative.
- Broad-based cross-country studies show the wide inter-regional variation that exists in business/state relations and in the degree of state capture by oligarchic interests (Joel Hellman and Daniel Kaufmann).
- A number of papers dealt with Russia where the reality appears to be farther from democratic and market ideals than in Central Europe (e.g., Alexandra Vacroux, Vadim Volkkov, Ekaterina Zhuravskya et al.).

A worry expressed by many throughout the region is that disillusionment may lead people to withdraw from political involvement or to be attracted by narrow nationalistic appeals. Unfortunately, these papers reveal that the disillusionment is, at least in part, based on underlying realities.

In spite of the weakness of formal rules and institutions, businesses and bureaucracies are coping with an imperfect legal and institutional environment in creative ways (Marie Mendes, Christopher Woodruff, Martin Raiser), but the costs of weak laws and dispute resolution mechanisms are high especially in Russia where the legal environment is particularly poor (Vadim Radaev, Alena Ledeneva). Sometimes businesses enlist criminals to help them engage in illegal deals (Vadim Volkov); in other cases organized crime infiltrates legal businesses. One concern for Central European countries is that some of their efforts to join Western Europe will be undermined by mafia groups from Russia and elsewhere which gain a foothold in their countries (Federico Varese).

A major point of contention in the draft papers and in the workshop discussions concerned the exceptional character of the transition in the post-Socialist states. One aspect of this is the role of the socialist past in the current transitions. Thus, Cynthia Horne and Margaret Levi discuss the alternative ways in which countries used lustration processes to exclude some members of the previous regime from holding office in the new one. Jens Andvig explores the relationship between the strength of the Communist party and the process of transition.

³ Full list of project participants see below.

There was considerable debate about the relevance of West European and American experience to the region. This took two forms: one involved the value of borrowing; the second, whether the post-socialist countries can learn from the experience of others.

First, can and should specific institutions that function in the industrialized democratic welfare states be transplanted to the region? Obviously, the basic democratic and market institutions are modeled after the experiences of other countries, but what about such specific institutions as financial market regulatory agencies, central banks, and Ombudsmen? Thus Katerina Pistor and Chenggang Xu argue that the institutions regulating financial markets in China and Russia ought not be imported whole from the industrialized countries but need to take account of the weakness of other institutions, such as courts. In this, they are supported by Ivan Krastev and Alexander Stoyanov's work on the difficulty of launching anti-corruption campaigns when the judiciary is weak (see also Claus Offe). These papers deal with countries that are among poorer and less reformed in the region, but similar issues arise in the European Union accession countries because they are being asked to implement a range of reforms to bring them into compliance with EU laws. The papers by Susan Rose-Ackerman, Andras Sajo, and Bruno Frey deal with such countries. Rose-Ackerman and Sajo consider the role of public participation and neutral institutions, respectively. They both point to the value of such institutions while recognizing the difficulties of establishing them in countries where the civil society is weak and the level of partisanship is high. Bruno Frey argues that referenda, a common feature of Swiss politics, can be successfully transplanted to Central Europe and, if implemented with care, can help increase the accountability and trustworthiness of government.

Second, what can one learn about the likely trajectory of the countries in the region by studying the experience of Western Europe and the United States? The relevance of the experience of established democracies is raised by Bo Rothstein, on the one hand, and Eric Uslaner and Gabriel Badescu, on the other. Rothstein argues that one can draw lessons from the Swedish experience in understanding the link between social capital and government performance. Uslaner and Badescu, in contrast, present evidence to show that the transition countries are quite different at least along some dimensions.

One important lesson, stressed by Russell Hardin, is that democracies can survive in spite of very deep divisions in the population over policy so long as there is widespread commitment to democracy per se. However, there are danger signs even in established democracies. Russell Hardin and John Mueller provide a valuable counterweight to those who argue that the region is experiencing special problems. Hardin and Mueller both cite data showing that trust in government institutions is low in the United States. Hardin argues that all consolidated democracies are essentially controlled by narrow elites with little claim of popular support. He is critical of this trend but does not see an alternative. Mueller essentially accepts Hardin's factual premises but is rather optimistic at least with respect to the stability of such democracies. They may not be very appealing, but they do not necessarily presage a return to autocratic rule. According to Mueller, one should accept the fact that real democracies cannot conform to an ideal of popular sovereignty and are only valuable because no narrow group can claim a long-term monopoly on power. Bruce Ackerman counters these arguments by claiming that American history contains important instances of mobilized, committed public debate and of leaders inspired by democratic ideals. This conclusion, however, is not necessarily an optimistic one for Central and Eastern Europe because it implies that these states need to attract leaders that are not only playing power games and to limit cynical disengagement from politics.

What overall conclusions can one draw from this collection of papers and the discussions that surrounded their presentations. The research bore out the value of making a clear distinction between interpersonal trust and trust in the reliability and impartiality of institutions. In many of the cases discussed, trust in individual family and friends to favor you was contrasted with trust that a set of rules would be followed in an even-handed way. Many of the problems of consolidating democracy in the region appear to stem from the remaining tendency of officials to do favors for

their friends and family. That said, two broad conclusions seem warranted. These conclusions are necessarily tentative and preliminary, but they are suggested by overall project.

First, the countries in the first round of EU accession have problems that do not differ in kind from similar difficulties facing established market democracies. However, because of the relative newness of their institutions and the populations lack of experience with constructive activity, these countries need to focus on reforms that will enhance institutional stability and predictability and enhance public involvement in political life.

Second, Russia, and by extension, the rest of the former Soviet Union, seem to face deeper problems. Although both bureaucrats and business people are coping in the face of adversity, the dysfunctional state and market institutions raise the risk of a long term period of weak democracy and inefficient markets. Here a number of authors were quite pessimistic, a pessimism that cannot be saved by Mueller's advice not to expect much from democracy. Nevertheless, even if the overall situation seems quite problematic, the individual papers did suggest ways in which particular problems might be alleviated. The basic ingenuity of businesses and ordinary people in the face of adversity suggests some hope that they can also respond to more constructive incentives.

Biographical Information on the Conveners

János Kornai is Allie S. Freed Professor of Economics, Harvard University, and Permanent Fellow, Collegium Budapest. He was President of Econometric Society (1978) and President of European Economic Association (1987). He is member of the Board of the Hungarian National Bank (the central bank of Hungary). He is member (foreign member) of the Hungarian, American, British, Swedish, Finnish and Russian Academies. He received academic awards in Hungary, USA, and Germany. He is the author of *Overcentralization* (1958), *Mathematical Planning* (1967), *Anti-Equilibrium* (1970), *Economics of Shortage* (1980), *Road to a Free Economy* (1991, published in 17 languages), *The Socialist System* (1992), *Highway and Byways* (1995), *Struggle and Hope* (1997).

Susan Rose-Ackerman is Henry R. Luce Professor of Law and Political Science, Yale University, and Co-director of the Law School's Center for Law, Economics, and Public Policy. She holds a Ph.D. in economics from Yale University. She has held fellowships from the Guggenheim Foundation and the Fulbright Commission and was a Visiting Research Fellow at the World Bank. She is the author of *Corruption and Government: Causes, Consequences and Reform* (1999), *Controlling Environmental Policy: The Limits of Public Law in Germany and the United States* (1995); *Rethinking the Progressive Agenda* (1992); and *Corruption: A Study in Political Economy* (1978); and joint author of *The Uncertain Search for Environmental Quality* (1974) and *The Nonprofit Enterprise in Market Economies* (1986).

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