

**EXPLAINING THE SIZE OF INFORMAL SECTOR:
THE ROLE OF TRUST, CORRUPTION AND BUREAUCRATIC
QUALITY**

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ÖYKÜ ULUÇAY

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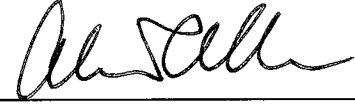
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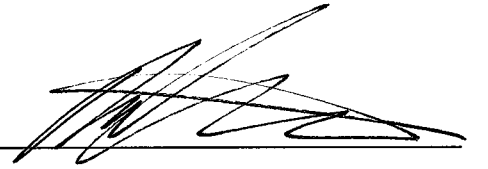
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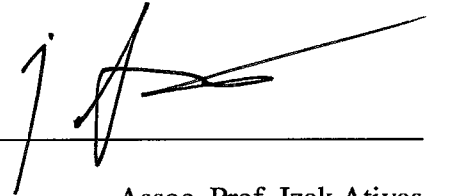
Assoc. Prof. Ali Çarkoğlu

Supervisor

Examining Committee Members



Assoc. Prof. Meltem Müftüler Baç



Assoc. Prof. Izak Atiyas

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ABSTRACT

Previously, studies on informal sector were under the monopoly of economists. The determinants of informality were set by economic criteria such as cost of registering a business, tax rates and GNP per capita. Lately, it has been discovered that in most of the developed world, the tax rates are significantly higher than in the developing world, but the informal sector size is considerably lower. This fact points out to the unexplored aspects of informality such as bureaucratic quality and corruption. What matters most is the quality of rules and procedures and the strictness of enforcement and punishment for the violators. On top of this, we have to add the psychological aspects of informality such as low confidence in state institutions. Just as in the case of psychological aspect of inflation inertia, informality can be a by-product of low levels of belief in the necessity of paying one's taxes.

In this work, a regression equation was created to test the impact of certain variables on the size of informality. Corruption and bureaucratic quality were included to measure the effect of an impartial bureaucracy on informality while confidence in state institutions variable was used to see if there is any psychological determinant of informal sector. Variables such as GNP per capita Cost to Register a Business, Overall Tax Burden and Employment Laws Index were the control variables which economists mostly mention as the underlying reason for informality.

The results of the regression equation showed that the combined variable of corruption and bureaucratic quality is the single most important determinant of informality, while confidence does not have much influence on the size of informal sector. Another important finding of the quantitative analysis was the confirmation of the fact that high taxes do not mean large informal sector.

Keywords: confidence, corruption, bureaucratic quality, informal sector, bureaucracy, regression

**KAYITDIŐI EKONOMİYİ AÇIKLAMAK:
GÜVEN, YOLSUZLUK VE BÜROKRATİK KALİTENİN ROLÜ**

ÖNSÖZ

Önceleri kayıtdıŐı sektör ile ilgili araŐtırmalar genellikle economicilerin tekelindeydi. Ekonomik kriterlerle seçilmiş- bir işletmeyi kaydetme maliyeti, vergi oranları, kiŐi başına düşen GSYM gibi- deđiŐkenler kayıtdıŐılıđın asıl nedenleri arasında sayılırdı. Son zamanlarda yapılan araŐtırmalar en azından tablonun tamamen böyle olmadığını, gelişmiş ülkelerdeki vergi oranları genellikle gelişmekte olan ülkelerden çok daha fazla olmasına rağmen kayıtdıŐılıđın onlara nazaran çok daha düşük olduğunu gösteriyor. Bu buluntu bize yolsuzluk ve bürokratik kalitenin etkileri gibi kayıtdıŐılıđın hala keŐfedilmemiş birçok yönü olduğunu gösteriyor. Gözükten o ki kuralların ve prosedürlerin kalitesi ve uygulamanın ve cezalandırma sisteminin güvenilirliđi çok daha belirleyici. Bunun üzerine devlet kurumlarına olan güven gibi psikolojik faktörlerin de eklenmesi gerekli. YapıŐkan enflasyonun psikolojik yönleri olduđu gibi devlete olan güvenin azlıđı da insanları vergilerini ödememeye yönlendiriyor olabilir.

Bu çalışmada çeŐitli bađımsız deđiŐkenlerin kayıtdıŐılık üzerindeki etkilerini incelemek için bir regresyon denklemi kullanıldı. Yolsuzluk ve bürokratik kalite, bürokratik tarafsızlıđın kayıtdıŐılık üzerindeki etkilerini ölçmek için kullanıldı. Devlet kurumlarına olan güven ise kayıtdıŐılıđın herhangi bir psikolojik boyutu olup olamayacağını öğrenmek için kullanıldı. KiŐi başına düşen GSMH, bir işletmeyi kaydetme maliyeti, Genel Vergi Yüktü ve Çalışma Yasaları Endeksi gibi deđiŐkenler ekonomistlerin çođu zaman kayıtdıŐılıđın ana sebebi olarak gösterdiđi bazı makroekonomik verileri kontrol deđiŐkenleri olarak çalışmaya dahil etme çabasının ürünüdür.

Regresyon analizinin sonuçları yolsuzluk ve bürokratik kaliteden oluşan kombine deđiŐkenimizin kayıtdıŐı sektörün büyüklüğünü ölçmede en önemli faktör olduğunu, güven faktörünün ise belirleyici olmadığını ortaya koydu. Bir diđer buluntu ise yüksek vergi oranlarının büyük kayıtdıŐı sektör anlamına gelmediđinin bir kez daha kanıtlanmış olmasıydı.

Anahtar kelimeler: güven, yolsuzluk, bürokratik kalite, kayıtdıŐı sektör, bürokrasi, regresyon

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CHAPTER 1: INTRODUCTION

The starting point of this study is the following question: Why do some countries have larger informal sectors than the others? Is it due to low levels of tax-morale triggered by low levels of confidence in state, or is it a side-affect of an incompetent bureaucracy with high levels of corruption? This is an important question to address when one tries to understand the policy-wise manipulable variables which determine the size of informality across countries. While bureaucratic performance might be a policy variable in the short run, confidence in state institutions change only in the mid to long run.

In this study I concentrate on whether confidence in state institutions makes a significant difference on the size of informal sector across countries. Keeping the question as simple as possible within a single equation framework I will test whether corruption, macroeconomic and policy indicators, as well as institutional confidence, are statistically significant in determining the size of informality.

It has usually been the sociologists and economists who made research on informal sector. Sociologists are mainly interested in issues such as re-causalization and re-ethnification of work, social networks, ties of ethnicity and religion that are embedded in informal activity and gender, child labor angle of informality. The re-emergence of waged homework (or putting out) is a context to question the exploitation of female labor. The re-emergence of sweat-shops where the laborer is deprived of even the most basic workplace security coupled with the absence of social security payments is a case to prove the disenfranchisement of workers rights. The prevalence of ethnic, regional and religious ties

among the groups operating in the gray, is a context to debate on 'embeddedness' of economic activity in networks of solidarity which provides the members of a group certain privileges such as the provision of start-up capital for establishing an enterprise, employment for a new immigrant who does not have much chance to find a job in the formal sector and even private protection for informal activity by the members of the same community (such as mafia). Such networks are also necessary for the smooth functioning of the informal business activity.

Economists in general and developmental theorists in particular are interested in the growth potential of informality. Well-meaning development experts believe that informal companies themselves will grow and eventually join the formal economy if they are given credit and other types of technical assistance, hence the popular "micro-credit" programs of recent years.¹ Others believe, that due to size limitations and low productivity of informal firms, they can never make the expected economic contribution to national economies.

The reaction of policy makers to informality has been largely characterized by ignorance if not outright support. Governments frequently view it as a social issue and fail to understand its damaging effect on productivity and economic growth. The informal economy, they believe, creates jobs for unskilled workers and relieves urban employment tensions.

With the same narrow-mindedness, when it comes to fighting with informality, economic austerity measures are the only solutions that come to policy makers' minds. A reduction in social security contributions, direct taxes and the value added taxes coupled with a shrinkage of bureaucratic regulations will surely mean that the costs of staying formal is lower. Yet, if everything could be explained in numbers, the size of the shadow economy across countries should have been strictly in proportion to the taxes demanded by their respective states. But this is not the case. Most Scandinavian countries have higher tax rates and a very strictly applied regulatory mechanism in comparison to many developing

¹ McKinsey Quarterly "Hidden dangers of Informal Economy" 2004, July No:3 at www.mckinseyquarterly.com

countries, yet their shadow economies are smaller than many. In addition, there is no evidence that the cuts in direct and indirect tax rates will be precisely matched by an increase in tax revenue. The cuts in tax rates can make the same effect as that of tax amnesties. The non-payers may come to believe that their noncompliance will either be responded with an amnesty or a reduction in tax rates. This may even remind responsible citizens of their too much 'good will' towards the state and hence further reduce the tax-paying citizenry. This means that the fight with informality should involve something more than economic austerity measures. The measures employed and the tactics used in this ambitious project should first and foremost be based on an understanding of political psychology of informal players and tax-payers.

What explains the ease with which citizens evade taxes? What explains their recalcitrant attitude towards intervention of state into their economic activities? Some scholars argue that staying informal has more to do with trust in state. Without revealing the sources of distrust towards the state reflected in the decreasing levels of tax-morale, there is no way of fighting with informality. If citizens do not believe either in the capacity or the good will of the state to use resources for the common good, they will not pay taxes. One reason for the distrust in state could be that the officials and politicians whom people associate with the state are believed to be corrupt. An increase in perceptions about corruption breeds higher distrust in state.

A competing point of view about informality is that as long as you achieve a high bureaucratic quality characterized by strict enforcement such free rider cases will be kept at a minimum. The cure lays less in creating trust in state than in looking tough. People engage in informal activity because they are allowed to. Especially when those institutions that are supposed to guide and regulate the economic activities of the citizens, are themselves prone to corruption, there is no way of blaming the citizens for being distrustful. They just adapt themselves into this web of rulelessness.

I will in this thesis rely on the findings of World Values Survey, in terms of calculating trust in state institutions. Perceptions of corruption will be estimated by Corruption Perceptions Index of Transparency International. I will rely on the findings of

Schneider (2002) for measuring informality across countries. Data on many other macroeconomic indicators such as overall tax rates (or overall fiscal burden), employment laws, cost to register a business and GNP per capita will be borrowed from reliable think tanks and nongovernmental organizations such as Heritage Foundation, Political Risk Group and World Bank. A multiple regression model will be utilized to test the significance of each variable.

The cross cultural nature of the study will illustrate if there are any universal patterns in terms of the link between trust, corruption, bureaucratic quality and informality. The findings of the work may be useful to policy makers in the sense that it will reveal the starting point for a well-designed policy to deal with and if desired eradicate informality.



CHAPTER 2: LITERATURE REVIEW

Informal sector has constituted an important question in the development studies starting with 1950s. After the decolonization of the developing world, the rapid social transformation that these countries lived through triggered mass migrations from rural to urban settings. The newcomers to cities were mainly motivated by a desire to acquire a job and earn a decent living. Further analysis of the situation revealed that this labor transfer from rural to urban working sites did not result in the immediate absorption of these immigrants into the modern sectors.² First, the newcomers had to acquire experience in the informal sector. Most of the time the immigrants ended up accepting low-paid and low-skilled jobs without any form of social security such as street vending.

For a long time, it was largely believed that informal sector was a specific feature of the developing world. Informal sector was a phenomenon related with underdevelopment and incomplete industrialization (Bulutay, 1998). It was an anomaly that had to be remedied with complete modernization of the economy and institutionalization of the workers' rights. The sweat-shops and the practice of putting-out were a distant memory for the advanced capitalist countries. Not only did they legalize trade union activism and workers' rights as a counterbalancing mechanism for the drawbacks of industrial revolution, they also achieved the institutionalization of 'the paying of taxes' as one of the founding

² I use the term modern sectors meaning relatively well-paid sectors which also provide the worker with a certain social security service.

principles of their state-building efforts. The 1950s, when the economists were making these comparisons between advanced capitalist countries and the developing world, also coincided with Keynesian welfare policies of the West where the working population were protected with lavish social security services. These were the times when even the most liberal economies of the world, such as USA, were making a 'New Deal' for their workers.

In such an atmosphere, the development studies which were heavily influenced by modernization school at the time put forward the idea that as the developing world adopted Western ways of economic growth and industrialization, all the labor force coming from the rural settings would eventually be absorbed by the modern urban sectors. There was a belief at the time about the developing world that economic modernization would eventually eradicate such low-paid low-skilled informal jobs, as small and medium sized firms gave way to big conglomerates organized along Fordist lines. Development experts believed that informal companies would grow and eventually join the formal economy if they were given credit and other types of technical assistance hence the popular "micro-credit" programs of recent years. It was also believed that the economic modernization would transform these informal workers into organized labor. Informal sector workers were mainly portrayed as 'peasants in the city' without any ideological orientation or affinity with a political party. By the time they acquired any political preference they would have become part of the formal and organized labor force (Sanyal, 1991).

When we came to 1970s, the findings pointed out to the fact that informal sector was neither marginal nor transitional and that informal workers were far from being a 'working class in embryo' (Sanyal, 1991).³ The pace and the structure of industrialization in the developing world could absorb only a portion of the informal labor force. What is more striking is the fact that even in the advanced capitalist world we witness a trend of informalization as the metropolises of these rich countries attract massive numbers of immigrants who can only depend on such low-skilled, low-paid jobs provided for them in

³ The World Bank estimates that this informal economy generates 40 percent of the GNP of low-income nations and 17 percent of the GNP of high-income ones. In some industries, such as retailing and construction, informality can account for as much as 80 percent of employment. Source: McKinsey Quarterly, July 2004, no: 3.

their ethnic neighborhoods. The literature on economic sociology of immigration is growing in the developed world due to the influx of massive numbers of immigrants to these countries. Most of the time immigrants operate informally since they are discouraged from jobs in the modern sectors of their host country.

Informal sector is serving an important function which is providing the subsistence wage for the survival of the urban poor both in the developed and the developing world. Keith Hart (1973) was the first person to coin the term “informal sector” and propose that informal sector constituted a complex, organized and dynamic portion of the urban economy, especially in the developing world and in the immigrant communities in the advanced capitalist countries. In line with this argument, International Labor Organization (ILO) with its Kenya Report popularized the concept by proposing that the acute unemployment problem and the social consequences such as mass starvation and rebellion that accompanied it could only be overcome with the existence of a vibrant informal sector that provides the urban poor with the basic survival mechanism (PREALC 1981). Promoting informality was both for unemployment reduction and a fight against poverty. A transition from the belief that informality will disappear with industrialization to a belief in the permanence and usefulness of informality took place.

When social scientists began to realize that informal sector was a permanent feature of both the developing and the developed world, they began to question what caused its genesis and permanence. With the revival of neo-liberal doctrines in 1980s, it was assumed by neo-liberal economists that informal sector was an outcome of an overregulated economy with unreasonable tax rates pushing firms into informality. Theoreticians such as De Soto (1989) proposed that informal sector represents the entrepreneurial side of developing countries carrying big potentials to become the locomotives of their native economies in the future. This was a clear deviation from the earlier belief that informal sector had no significant contribution to economic growth.⁴ The revival of neo-liberal doctrines reanimated the old discourse of laissez-faire, this time to the benefit of informal

⁴ The reason for such a stance was that informality necessitated staying small and this smallness syndrome meant a limitation on economies of scale.

sector players. The neo-liberals advocated the relaxation of state's regulatory role over small and medium sized enterprises and the promotion of informal sector in the name of promoting entrepreneurship and economic growth. Maldonado sums up this argument as follows:

“...on this supposition legal instruments are the main influence-outweighing economic, social and cultural factors- on the emergence and survival of the informal sector, because of a restrictive, off-putting administrative and legal framework. Lengthy legislation procedures, complex administrative steps and the costs involved in legalizing an enterprise combine to deter enterprises from operating legally” (Maldonado, 1995:5).

For many economists, increasing informality is a reaction given to the politicization of economic activity. The exercise of control rights such as regulatory powers over privatized firms, the ability to regulate and restrict entry, control over the use of land that private businesses occupy, the determination and collection of taxes, the right to inspect firms and close them if the regulations are violated, is a clear distraction for business activity (Johnson, Kaufmann and Lobaton, 1998:3). Especially in the developing world, where the transparency and accountability principles are not instituted at all, many of these control rights are used for the private enrichment of state officials by interfering into economic decisions when their interests are concerned. When entrepreneurs become aware of the fact that their profits are taken away through regulation, taxation or corruption, they choose to operate unofficially.

But such neo-liberal propositions are also flawed. For example, Europe with a fair amount of regulation does not experience as much informality as it is experienced in the developing world (Portes and Schaufli, 1993:47). The experiences that Russia lived through also contradict neo-liberal arguments. Laissez-faire advocates were arguing that too much regulation causes informality. The Soviet second economy-as it was called in place of informal sector- was a proof of this proposition. As has been noted by Kosals (1991) there was a widespread opinion during the Gorbachev era that shadow economy was the result of highly bureaucratized Soviet system that could only be eliminated by liberalization and a transition to market economy. To the extent that the country was

integrated to capitalism the shadow economy would diminish. Yet, just the opposite happened. Today, illegal activities constitute a significant portion of Russian economy. The problem with economic liberalization in countries like Russia is that, in those areas where freedoms are formally permitted, guarantees and protection on the part of the state are lacking. As the rules of the game are lacking, the population and business people tried to enter into primarily unofficial relations with bureaucrats not representative of the state and its formal rules but rather as private individuals who can offer services at a certain price. This is a direct result of the drastic privatization of the economic activities of the public sector and a sharp decrease in the authoritative powers of the state in the economy. In the Russian case, as the rapid economic liberalization increases the uncertainty regarding the roles, functions and rights of state bureaucrats, they, as people, possessing the most significant business experience during the Soviet era effectively privatized their jobs. As a result of this, when an entrepreneur turns to state for protection, this is not achieved through laws, but through the hiring of private services of some state official. The population considers the payment of taxes as dual taxation as everyone buys state services privately (Kosals, 1999:7).

Contrary to *laissez-faire* advocacy of neo-liberals, those on the left consider informality as a new method of big business to bypass labor unions and subcontract pieces of their work at lower wage rates (Weiss, 1987). Behind the rhetoric of promoting entrepreneurship and national growth and being a safety net for the poor, the informal sector is depressing the already declining wage rates in the formal sector thus pushing even formal workers into informality. Informal economy means the disenfranchisement of the institutionalized power conquered by labor (Portes, Castells and Benton, 1989:11). It turns industrial workers into self-employed artisans, part-time home laborers and odd jobbers who do not even consider themselves as a part of working class.⁵ One example given for this the hypothesis is the case of Italy. There, the victories of labor unions brought about a serious decline in the capitalist profits especially in the 1960s. This situation has only been

⁵ This fact is highly relevancy for the case of women, who, although making a significant contribution to family budget that sometimes exceeds that of their husbands, do not consider themselves as workers or breadwinners.

reversed, with the subsequent proliferation of artisan enterprises which were made exempted from provisions of tax-code and statute of labor if they employed less than fifteen workers. This decentralization, as one can guess, gave an initial stimulus to the expansion of informal sector in Italy (Portes, Castells and Benton, 1989:23).

Today, in many countries, both developing and developed, the practice of subcontracting is one of the indispensable strategies of big firms to sustain their competitiveness. The rhetoric of international competitiveness became especially more acute after the economic crisis of 1970s. When the boom years of import substitution policies came to an end with the OPEC oil-crises, millions of people became unemployed. In that kind of a desperate situation, people accepted the most humiliating working conditions for the sake of sustaining their daily living. Big firms in trying to recover from the supply-side shocks of the 1970s utilized downsizing heavily and preferred outsourcing pieces of their work to small and often informal enterprises to decrease labor costs. The critical question about this last global downturn is whether this reversal in the relationship between capital and labor is temporary or not. The expulsion of a significant portion of the proletariat into the ranks of unemployed and the decentralization of the working environment coupled with the willingness of urban poor to endure harsher working conditions for personal survival enhanced opportunities for exploitation (Portes, Castells and Benton, 1989:309).

Obviously for such a socio-economic transformation to take place the state has to approve the current arrangement or at least should show signs of inertia to fight with informality. The abuse of labor regulations can only take place if the state is too weak to enforce its rules, or if the governments turn a blind eye to the situation to promote competitiveness of formal sector firms, economic growth, employment opportunities for the poor or simply to guarantee votes for the upcoming elections. The moving boundaries of the informal sector will depend on the dynamics of social struggles and political bargaining.

Neo-liberals advocate that what the informal sector can accomplish will only be realized if we could successfully get the state out of the economy. Yet, contrary to such

assumptions, governments' response to informal activities in most of the developing world did not take the form of a hostile reaction to such activities as a form of tax evasion. On the contrary, the relations had been marked by support and getting the state into the economy to provide the necessary support to small scale entrepreneurial initiatives. There are obvious reasons for such state tolerance. The state may be tolerating these activities because it is a survival mechanism of the poor and especially in the developing world the poor constitute the bulk of the electorate. Any move to eradicate informality, i.e. the demolishing of illegal housings or the closing down of informal sweatshops, will mean a loss of votes for the incumbent government. The private enrichment of state functionaries can also be counted as a reason. The promotion of the competitiveness of formal sector firms, by legalizing subcontracting arrangements is also another reason for such state tolerance.

Local or municipal governments seem to be more crucial in the growth of informality since they are not circumscribed by the policy debates that paralyze national-level initiatives nor do their decisions have an impact on the overall macroeconomic objectives.⁶ Central governments concern about macroeconomic objectives may explain the slowness with which governments have responded to decentralization and informal sector expansion (Portes, Castells and Benton, 1989:307).

The interest in informal sector in Turkey is also on the rise both due to the scale of such activities and the current determination of the government to fight with informality. With ever increasing urbanization rates and deregulated markets a safe haven is created for informal economic activity ranging from Laleli district transnational shuttle traders to neighborhood grocery stores, from restaurant owners to bakery shops, from tailors to textile producers. The importance of informal transnational trade is so great that even the Trade balance of Turkey had to be adjusted with 'shuttle trade' magnitudes. It is not only the

⁶ In India and Russia, for instance, local governments force local power companies to provide free energy to some businesses; subsidies such as these allow informal businesses to continue operating. Source: McKinsey Quarterly, "Hidden dangers of Informal Economy" July 2004, no:3 at www.mckinseyquarterly.com.

transnational aspect of informal sector in Turkey that makes it so important. Living with informality has huge political, economic and sociological consequences.

Economically living with an expanding informal sector means the use of backward technology, lack of innovation and investment in the enterprise and the human capital. It also creates an active labor force that escapes official statistics. It is true that the informal sector has a job creating potential and has an economic contribution to GNP. Yet, the potential for economic growth of such small enterprises is no match with that of large-formal firms whose returns to scale is beyond comparison with informal firms. Despite their low levels of productivity and smaller scale, the substantial cost advantages that informal companies gain by avoiding taxes and regulations helps them stay in business. Competition is distorted because inefficient informal players prevent formal companies from gaining market share. Any short-term employment benefits of informality are thus greatly outweighed by its long-term negative impact on economic growth and job creation.

Sociologically it means the continuing abuse of child and female labor. The portion of the labor force that is most prone to abuse, low-pay and harsher working conditions is that of children and women. Putting-out is still a very widespread practice among women, who at times contribute more to the household economy than the traditional breadwinners. The irony in all of this is that they do not consider themselves in any sense as a worker or an equal breadwinner let alone an exploited laborer. In addition, countries with greater disparities between rich and poor have larger informal sectors. The poor will find it difficult to get jobs in the formal economy and will be forced to find an opportunity in informal sector (Uslaner and Badescu, 2004b:14).

Before tackling the political side of the phenomenon, I have to explain what is meant by informal sector in the simplest sense of the term. The standard definition that one can use for informal sector is “a process of income-generation which is unregulated by the institutions of society in a legal and social environment in which similar activities are regulated” (Portes, Castells and Benton, 1989:12). This definition encompasses the totality of informal activities, but due to its generality, it does not capture the variety in the informal sector. Apart from being called a sector, the range of activities undertaken within

the informal sector is far from being identical. When decomposed into its sub-segments, one gets a better picture of its diversity.

Jim Thomas (2001) offers two useful criteria in trying to expose this diversity within the informal sector. One is whether market transactions are involved, the other is whether the goods and services or the processes of production are legal or illegal. Household sector does not involve market transactions, goods and services are produced within the household. The informal sector produces goods and services in an unregulated way. The underground sector refers to the production of goods and services that are legal but the processes of production and distribution remain illegal, usually in the form of tax evasion. In the criminal sector, the goods and services as well as their production and distribution remain illegal. All these three components make up what we call informal sector.

This definition covers a diversity of activities, ranging from a private tutor whose price for a one-hour math lecture is 100 million TL, to a street seller who earns hardly 100 million TL for a month. Precisely, due to this multi-faceted nature of the informal activities, the equation of informality studies to poverty studies is questionable. For many scholars, the informal economy is not a survival activity performed by 'marginal people' trying to get over the subsistence line. A quotation can be useful here:

“Studies in both advanced industrial and less developed countries have shown the economic dynamism of unregulated income-generating activities and the relatively high levels of income of many informal entrepreneurs, sometimes above the level of workers in the formal economy.... The informal economy is not a euphemism for poverty....Although most of the people engaging in informal activities are poor, especially in the Third World; informal economic practices cut across many social structures” (Portes, Castells and Benton, 1989:12).

These studies point out to the fact that people working in the informal sector are not homogeneous. The informal sector is based on a relationship between a waged laborer who does not possess any legal protection and social security and an informal entrepreneur who is either in subcontracting relationship with formal firms, or is directly marketing the produce of the workers. In most of the cases the informal entrepreneurs and employers are

better off than formal sector workers.⁷ In cases where the firm at hand is a family firm or industrial homework, they do not even consider themselves as workers, exploitation is hidden under complicity.

Leaving aside the role of informal sector for economic growth and survival of the poor to development theorists, we would like to dwell on the political consequences of living in informality. In press and academic publications, we usually talk about what the big business thinks about certain state actions, what it wants from the state, its ideological positioning etc. Of course, we can not expect informal sector to have that much a stake in the 'high politics' of any country. Informal sector players are not organized like big conglomerates since they are usually in the form of small and medium sized enterprises , but that does not imply that they do not have an effective voice in shaping local government's policies or that they do not have any stake in being involved in politics.

A very good example that illustrates how the state has to accommodate rather than regulate such illegal practices is the case of land markets in Turkey. In his work on “Land, Shelter and Informality in the Periphery” Keyder (2000) argues that what distinguishes the expanding informal sector in the periphery countries from that of the informal sector in core countries (since informality is also on the rise in the advanced capitalist world) is the divergent perceptions of 'law of real property'. This different perception directly affects the attitudes about legal order and state.

In the case of big cities of Turkey such as Istanbul, Ankara, Izmir, Bursa large portions of the population live in illegal housing. In some cases, these buildings are built on public land or land belonging to private owners. In other instances, the construction has violated zoning regulations by building on farmland, green area or construction has been carried out by ignoring construction regulations (Keyder, 2000:120). A measurement of the contribution of illegal constructions to informal sector is lacking. Keyder proposes that it could very well be the most important component if we consider the fact that informal

⁷ The study conducted by Eder (2004) in the Laleli district transnational trade point out to the fact that shop owners despite the risks of going bankrupt due to the volatility of their business, earn incredibly lucrative salaries compared to an average Turkish citizen.

neighborhoods (shantytowns in daily language) constitute from a quarter to the half of total building stock in large cities of the developing world.⁸ The value created by the family labor during the preparation of the plot, construction of the building and the continuing additions, do not appear in figures of the formal economy. What is more, the value created by this illegal building stock is always increasing due to two reasons: The houses are always in the building process and the rent of the building increases as it turns into an apartment and moves into central or desirable districts due to further expansion of the city.

What is the reaction of the state towards all this illegal activity? Is it a mere observer, a contributor or a fighter against such informal activity? Some observers refer to the current inertia of local officials in the face of proliferation of shantytowns as “the benign negligence of the state” that can be justified on moral grounds (Buğra, 1998). The concept of moral economy dates back to middle Ages where many societies held a popular consensus about what constituted legitimate or illegitimate practice on the part of the state. For example, the food riots in 18th century England did not occur out of a sheer desperation of hopeless people. These people considered the provision of cheap bread as a moral obligation on the part of the state and the failure to do so triggered mass outrage. The current immigrants seem to refer to the same old notion of this morality when they defend their shantytowns. The obligation of the state in satisfying the basic necessities of the masses forms the basis of such expectations and paternalist politicians take a lenient position in the face of land plunder by new immigrants. The state, torn between accepting capitalist principles of ownership and the moral economy, had to give in to the popular demands of mass immigrants as it could not come up with a viable solution to accommodate these newcomers. The problem stems from the deficiencies of the redistributive mechanisms in the face of hyper-urbanization. The state as it failed provide the urban poor with redistributive mechanisms such as cheap housing or subsidies had to

⁸ In a labor-intensive sector such as construction, the informality can go up as high as 80 % of employment. Source: Mckinsey quarterly “Hidden Dangers of Informal Economy” July 2004, number:3 at www.mckinseyquarterly.com.

give consent to these illegal practices.⁹ The problem lies in the inability of the state to replace redistributive mechanisms with that of communal networks and reciprocity. In the end, the society perceives the legal order presented by the state as a burden that has to be bypassed, battled or bribed (Keyder, 2000:128).

Furthermore, what can be initially regarded as generosity or open consent on the part of the state can very well give way to negative reciprocity (Buğra, 1998:308). What is meant by this negative reciprocity is the expectation of both the state officials and the rentiers that they will be better off if they maintain the survival of this order. State officials will guarantee votes or economic benefits, i.e. bribes, with a timely ignorance just before the elections the rentiers will legalize their business and be able to market their now multi-storey apartments. So, it is really hard to draw the line between where the state is deliberately being generous, and where it is captured by parochial interests. In fact, most of the time, state agents are engaged and embedded in this patronage network for the sake of their own interests.

Hence informal economy comes forward with its own informal political institutions which comprises of clientelism, patronage, mafia-type relations and corruption. Corruption and clientelism can also be observed in the relations between big formal business and the state, but it is not the rule of the game. In informal sector however, the survival of the whole sector depends on the deliberate negligence of the state. So what we have in hand is more of an embedded corruption than a pragmatic state (Eder, 2004:18).

One proposition that I will make is that in those countries where there is widespread corruption, one should also expect to see large informal sector. This proposition will be tested when I do the quantitative analysis. Secondly, the level of corruption is very much related to the bureaucratic quality of countries. In places where the bureaucracy has

⁹ The depiction of the problem of illegal housing by media as a last resort of helpless people instead of an open violation of property rights also manifests the ways in which the society perceives the case. For an excellent evaluation of immoral economy of housing look at Buğra (1998).

impersonal functioning mechanisms with qualified personnel, corruption will be less likely to overwhelm the country in perspective.

Before trying to formulate the relationship between corruption and informality, I have to talk about the ways in which a society might perceive an action as a corrupt one, rather than a legitimate form of behavior. I will define corruption as “the use of power by political authorities and/or public servants outside their duties, in order to serve personal interests or the interests of those who, they feel, belong to the same group as themselves” (Adaman and Çarkoğlu, 2003:120). This definition encompasses acts such as bribery, favoritism, nepotism, cronyism and political clientelism. Obviously such practices bring the most lucrative profits where the business and political interests meet. According to Bayley (1999) societies, in which corruption has become a common practice, the following hazards are expected to occur:

- The resources which could be allocated to public benefit, goes to private pockets, hence undermining distributive justice. When corruption brings great economic benefits to a small minority in society, it aggravates income inequality.
- Corruption means a rise in the costs of public administration. The man who is a taxpayer and also forced to resort to bribery is paying a double price for the same service. Hence it creates great market inefficiencies. It also undermines business productivity, as resources which could be used for innovation or other improvements are used for lobbying.
- In societies where there is pervasive corruption, domestic entrepreneurs are discouraged from making new investments. Not only would domestic investors flee the country, but also foreign investors would also not consider the country in question as an attractive investment region.
- The pervasiveness of corruption in the public institutions undermines the morale of both honest public officials and good willed citizens. It lowers respect for political authority and decreases the legitimacy of political institutions. With the conviction that 'corruption does pay' man-in-the street also loses his of merit-based understanding of personal achievement, starts to look for ways of creating special contacts, rather than invest

in personal improvement. The implications of this kind of an understanding is destructive both at the individual and collective level. A person who thinks advancement in life depends on connections and favoritism will lose his sense of control over his life. Such low morale, if applied for the whole society will mean loss of idealism and devotion to moral values and a disbelief in citizenship responsibilities. The most obvious example of this disbelief shows itself in the case of taxation. If the image a society has about the politician and the public official is 'corrupt', it would be naïve to expect a sense of responsibility towards the state (Bayley, 1999:943).

Despite the fact that the criteria to distinguish what is corruption and what is not, is very straightforward, public perceptions about what constitutes an act of corruption may differ substantially from the definition we have made above. As Bayley points out “an act is corrupt if the surrounding society condemns it” (Bayley, 1999:938). In many developing nations, it is quite legitimate to make gift payments to officials, to use official positions to obtain jobs for relatives or to give a private fee to tax collectors for ignoring the informal business. In that sense it is difficult to apply Western moral codes to determine what should be condemned as corrupt behavior. One explanation for such societal differences comes from Rose-Ackerman:

“Societies based on strong interpersonal relations may have little notion of formal agency-principal relations and the obligations they impose on agents. The idea that one has distinct responsibilities to a superior-separate from ties of loyalty, friendship and kinship-may seem strange and unnatural. Such societies will have difficulty establishing modern bureaucracies, with civil servants hired on the basis of skills who are expected to separate their roles as officials from their roles as friends or relatives. Citizens expect that personal ties with officials are needed to get anything done and think it quite appropriate to reward helpful officials with gifts and tips” (Rose-Ackerman, 1999:106).

In such societies loyalty to family, friends and coworkers dominates loyalty to state. It is argued by some scholars that the societies that would mostly disapprove of petty corruption as a harmful phenomenon are those which do not live with it (Uslaner and Badescu, 2004a:10).

Secondly, it is true that elite malfeasance creates a loss of faith among the citizens. But as long as the citizens are able to get their share from this immoral practice, the

damaging affects of corruption on the political psychology of citizens is not as big as it might be expected. Johnston argues that corruption can be an integrative force if it is routinized in a society (Johnston, 1999: 992-1003). If corruption in a society is characterized by ease of joining, if it is inclusive, it will have an integrative force and its illegitimacy will not be questioned. For example, unfair enrichment of high state officials will be disapproved by many people and undermine the trust in state institutions because only a small fraction of people can benefit from such big corruption cases. Yet, what we call petty corruption, those gifts and tips that we all resort to when needed, are forms of behavior that everybody can benefit from, hence inclusive.

Informality in that sense falls into integrative and inclusive form of corruption. In line with Johnston (1999) I will call informal economy as market corruption since it bypasses market regulations such as product quality, health and safety restrictions, rules of market competition and taxation policies. Yet, due to its inclusive and integrative nature-as it draws buyers and sellers into networks of mutual self-interest- it can become quite large and pervasive.

The link between corruption and informality should be decomposed into two categories, that of petty corruption and big corruption. One interpretation about the link between corruption and informality is that perceptions about the prevalence of big corruption in a society, that is unfair practices at the highest political positions, breeds distrust in the state, hence this exclusive form of corruption might be breeding disobedient behavior such as not paying your taxes and engaging in informal economy. Yet, it could also be the case that, big corruption does not have that much influence on routinized practices such as informality. It could very well be the case that people consider such informal practices as normal and beneficial for the society and they may see no reason in condemning it. In countries where there is widespread corruption one may not automatically observe low levels of trust in state as long as people get their fair shares from this practice.

What about the relationship between trust and informality. In the informal sector, economic activity usually goes along with principles of reciprocity. The members of the

same ethnic, racial and religious identity are responsible for the well being of each and every other member of the same community.¹⁰ Especially in the urban informal sector; family members, relatives, ethnic ties may constitute the only safety belt for these people. Most of the time, an informal sector worker is either working for a family enterprise or for an entrepreneur whom he has a provincial, ethnic or religious tie. The relationship may perfectly look like the one between the capitalist employer and the exploited worker, yet neither the worker nor the employer sees themselves and their relations as an exploited-exploiter relationship. Complicity rather than exploitation is the norm. Such communal solidarity guarantees peaceful relations among firms with same local origins and peaceful relations between the enterprise owner and the workers who are often relatives. In their relations they rely more on this communal solidarity more often than the enforcement of the state. In the smooth functioning of informal sector, trust is more crucial than state guarantee since informal sector actors cannot rely on the legal enforcement in the case of a breach of business promise. The use of these ethnic, religious bonds would not be surprising in an illegal business where promises and words have to take the place of written contracts and bills; and where norms, values, reciprocity and trust matter more than state enforcement. That is why in most developmental studies, social capital usually takes the place of bank credits, promissory notes and many other legal instruments to make business. For example, the rotating credit associations are a clear sign that informal activities that operate outside the guarantee provided by the state have to rely on nothing but trust, networks and norms.¹¹

¹⁰ In the case of Islamic economy, Kuran thinks one of the major factors that has fueled economic Islamization is that an Islamic sub-economy helps its participants cope with the prevailing adversities by fostering interpersonal trust. The Islamic sub-economy enables the newcomers to big cities like Cairo and Istanbul to establish business relationships with a diverse pool of ambitious, hard-working, but culturally handicapped people. Their shared commitment to Islam keeps many of their activities within social circles in which information about dishonest behavior spreads quickly, thus providing a basis for mutual trust. Look at Kuran (1995) for details.

¹¹ In rotating credit associations found in many countries around the world, members contribute to a regular fund all of which is given to a single member on a rotating basis. The question relevant to social capital literature is: why do not the participants drop out

Economic sociologists when talking about social capital and trust operating within informal economy, usually invoke the instrumentality and vitality of solidarity networks such as neighborhoods, ethnic and religious ties and closed family structure. They refer to re-ethnification of identities, which means being from the same city, region or ethnicity which did not have much meaning before, gains enormous instrumentality once people migrate to new localities. The durability of such informal ties created by successful immigrant groups may have less to do with the long term persistence of outside discrimination than with the ability of these networks to compete effectively with resources and rewards available in the broader society ¹² (Portes and Sensenbrenner, 1993:20).

The trust in state and trust in one's close circle take on totally different meanings in the case of informality. It is obvious that there is no reliance or trust in state in the informal sector. In fact, state's lack of competence and legitimacy may very well be the reason for large scale informality. In the case of judicial matters related to keeping of business promises, people do not trust the state to resolve disputes fairly and efficiently, so they look to alternative sources of justice. Trust in state has nothing to do with close personal ties. In weaving such intimate ties with others people expect favoritism and certain privileges, whereas trust in state usually breeds an expectation of fairness and procedural justice. Rose-Ackerman (1999) argues this parochial trust based on personal ties, facilitates corrupt practices. The closer the ties you have with your intimate circle (who are usually your coworkers in your informal business) the more favors and privileges you expect from your close associates.

Here, it will be useful to make a clear distinction between the trust used in economic sociology and political science. Economic sociologists when talking about social capital and trust operating within informal economy, usually invoke the instrumentality and

once they receive the pot? Answer lies in the interpersonal trust. Without it, such associations would not have been possible.

¹² For example, Eder in her research on Laleli shuttle trade found out that there are basically three main solidarity groups within Laleli market. One is the migrant community from Yugoslavia and Bulgaria. The other is the Kurdish community. The last one is the Islamic community. In fact, most of the members of LASIAD, the businessmen association of Laleli are rumored to be both religious and mostly from Erzurum (Eder, 2004: 12).

vitality of solidarity networks such as neighborhoods, ethnic and religious ties and closed family structure. In political science literature however, trust in others takes on a different meaning. Trusting your relative, neighbor or friend is not a sign of social capital since it is quite normal for a person to trust somebody that she/he knows well. Social capital should make you trust your fellow citizen, so that you can believe in the possibility of working for a common cause with somebody that you do not know very well.

A brief theoretical background on the notion of trust as an important component of social capital in political science literature will be useful here. We will define social capital in a very broad fashion as obligations and expectations, information channels, norms and effective sanctions that shape the attitudes and actions of members of a specific community, be it a neighborhood, a criminal band or a nation (Tonkiss, Passey, Fenton and Hems, 2000:78).

Scholars' conceptualizations of social capital have largely varied. The narrowest of all belong to Putnam (1993). Putnam defines social capital as a set of "horizontal associations" among people who have an effect on the productivity of the community. These associations include "networks of civic engagement" and social norms. These networks and the norms associated with them facilitate coordination and cooperation for the benefit of the participants (Serageldin and Grootaert, 2000:46). In his path-breaking work on Italy, Putnam defines the single most important determinant that makes democracy work and which also distinguishes North Italy from the South as the 'civic engagement' which he measured with indicators such as the vibrancy of associational life, newspaper readership and political participation. He also proposes that strong personal ties (such as kinship) are less crucial than weak horizontal ties (such as acquaintanceship in a civic association) for the maintenance of a strong civic culture (Adaman and Çarkoğlu, 2003:128).

The proposition that Italian society is marked by low levels of interpersonal trust has a long history. The first scholar to observe this was Banfield (1958). He calls the specific form of this low trust in others in Italy as "amoral familism"- the absence of feelings of moral obligations towards anyone outside the nuclear family. The order of the day is: "Maximize the material, short-run advantage of the nuclear family; assume that all others

will do likewise” (Banfield, 1958:83). Banfield attributes this inability to act together for the common good as a side-affect of extreme poverty and backwardness (Misztal, 1998:193).

Gambetta makes an extension to this debate by arguing that amoral familism is not irrational but the only survival strategy in the harsh living conditions of the southern Italy. In a situation of centuries of oppression and poverty, it would be highly naïve to expect people to be supportive of the state or any other collaborative alternatives. Lack of trust in the institutions of the state and the communal mechanisms leaves the only refuge in the immediate family or certain patronage networks like Mafia. The emergence of mafia takes place when two conditions are met: where there is demand for private protection because of lack of trust in the community and the state and where there is the presence of supply of it (Gambetta 1993:3352, Misztal 1998:195).

Mafia uses its resources of loyalty and resulting expectations of behavior for illegal activities which is a part of informal economy (Deakin, 2001:72). If analyzed closer, it will be realized that the defining characteristics of mafia such as obligations and expectations, norms and effective sanctions and informal information channels are all defining characteristics of social capital. In fact the lack of positive characteristics of social capital- namely, high levels of interpersonal trust, the faith in civic engagement as a way of improving society- creates another form of social capital which is negative in essence due to its being closed to outside world and being to the detriment of the healthy functioning society. So, Putnam's conceptualization of social capital in which he equates social capital with civic engagement and political activism is just one face of social capital. There is also negative social capital which emerges as a specific form in the case of mafia and amoral familism. Of course, the emergence of mafia is also a specific feature of societies with low levels of trust in the protection provided by the state, yet it does not change the reality that it is a highly reliable and closely knit organization with its norms, obligations and expectations.

Another criticism about Putnam's understanding of social capital is “his neglect of vertical networks and the positive role the state can perform” for boosting the trust and

social capital in society (Deakin, 2001:76). The usefulness of Coleman's definition of social capital becomes more apparent at this instance. He provides a broader definition by depicting social capital as “a variety of different entities with two elements in common: they all consist of some aspect of social structure and they facilitate certain actions of actors- whether personal or corporate actors- within the structure” (Coleman, 1988:598). This definition enables scholars to extend the definition of social capital to vertical as well as horizontal networks and the behavior of other entities such as firms (Serageldin and Grootaert, 2000:46). Another contribution of Coleman to the literature is his claim that “a given form of social capital that is valuable in facilitating certain actions may be useless or even harmful for the others” (Coleman, 1988:598). In this way, one can point out to the existence of mafia as a specific form of social capital but will also observe that this kind of social capital is to the detriment of other forms of engagements such as associational life or healthy functioning state-society relationship.

The inclusion of vertical networks into the definition of social capital is crucial. The weak horizontal ties as envisaged by Putnam are not enough to explain the emergence of high interpersonal trust in a society. Misztal argues that “not only relations among people and the density of their networks but also trustworthy government, having support from and contributing to increasing satisfaction in the functioning of institutions, can play an important role in creating and maintaining trust. In turn this social capital can enhance institutional performance by lowering the cost of information about the trustworthiness of others, thus enhancing an informal solution to the problem of cooperation” (Misztal, 1998:198). Of course the state and society have their different logics as well as their intersection points. But one thing is for sure: State structures and institutions such as government, political regime and rule of law, court systems and civil and political liberties have an obvious effect on fostering political and social activity among the citizenry. The state and its institutions are responsible agents to foster social solidarity and reduce social tensions (Misztal, 1998:209).

If the society perceives the state and its institutions as negligent, corrupt and oppressive, the citizens will see no good in coming together to influence politics or engaging in any association. Hirschman's classification of exit (desertion), voice

(articulation) and loyalty seems very useful in trying to explain both inertia and dissident behavior on the part of citizens (Hirschman, 1970:80). It is not enough to have a voice option in the system to get engaged in political activism, what is also needed is loyalty to the existing political order. If there is no loyalty to the system coupled with a non-conducive environment for expressing the resentment, the exit option will be more heavily utilized which will contribute more to the belief that nothing can be changed with collective action. If everybody thinks in that fashion, nobody will believe in the power of collectivity which will further reduce the interpersonal trust that is needed for civic engagement. The examples in which voice and loyalty options is missing, what is commonly observed is decreasing levels of solidarity and a dismantling of the relationship between economic interest and loyalty (Miształ, 1998:201).

One example for this is informal economy. The emergence of informal sector can be attributed to the increase in unemployment (usually made up of unskilled immigrants) and lack of positions in the formal sector. The desire of big business to remain competitive in the (inter)national context is also conducive to informality. Yet, economic reasons are not adequate to explain why the citizens, firms, workers and employers are recalcitrant towards state intervention into their economic activities. The persistence of informality as a specific form of tax evasion and corruption has its roots in the political realm.

What is then the relation between informal economy and social capital? Especially how are we to relate this primarily economic phenomenon to state-society relations? The political dimension of the matter becomes clearer when informality is conceptualized as a specific standing vis-à-vis the state characterized by corruption and tax-evasion.

In this thesis I approach informal economy as an important component of corruption which we named as market corruption (look at p.19). The main reason for such a conceptualization is that informality means the breach of market regulations such as product quality, health and safety restrictions, rules of market competition and taxation policies. But, such a breach of law is not enough to call informality corruption. What makes it a type of corruption is the deliberate ignorance of political authorities or public servants in order to serve personal interests or the interests of those who, they feel belong to the

same group as themselves. Informal enterprises sooner or later attract the attention of state officials. At those critical instances, their survival depends on their ability to establish 'intimate ties' with lower level state officials through corrupt deals such as gift payments.¹³ As informal sector consists of production of goods and provision of services which do not appear in the formal economy (as a part of GNP), any corrupt deal (such as gifts, tips and bribes) made between state officials and informal players is a service transaction not billed and registered, hence a part of informal sector per se. If the survival of informality relies on the prevalence of corruption in society, it should be our duty to point out to this relationship to offer policy recommendations.

An expanding informal sector also means pervasive tax-evasion. Paying taxes is maybe 'the' most important citizenship responsibility in modern state. If a society is composed of a significant portion of people who think there is no need to pay taxes or that if caught, paying bribes would solve the matter, than there surely is a crisis of state-society relations. People should be thinking that either the state is incapable of delivering the services it is entitled to with the taxes it collects from its citizens, or they may be thinking that even if service delivery is possible, it does not take place on an impersonal basis, some people are favored over the others in terms of reaching such services. And if they think that having access to resources has nothing to do with fulfilling your citizenship responsibilities, with a rational choice they will opt for being a free-rider rather than a cheated responsible citizen.

Economists usually refer to this phenomenon as free-rider or collective action problem and assert that it has nothing to do with trust. Compliance is not a function of trust, but is a function of enforcement capacity of the state. Why should a trusting citizen comply if the same benefits are available without compliance? It would be easy to detect non-compliant members in a small tightly knit society but in our modern world the mass societies we are living in, non-compliance is harder to detect and punish. Despite this

¹³ Eder (2003) in her work on Laleli shuttle- traders explores the dimensions of this kind of an embedded corruption. Almost all of the shopkeepers interviewed admitted that they resort to bribery whenever needed and that Turkish state officials such as police, municipalities, tax collectors and customs officials are all part of this game.

opportunity, not all the people opt for being free riders. Scholz in his surveys on tax-payers' behaviors found out that variables such as trust in government and trust in citizens and a sense of duty were very effective in shaping decisions about paying taxes, even after controlling variables such as 'fear of being caught' (Scholz, 1998:144-156).

There are two highly relevant examples: Post-communist and Scandinavian countries. These examples depict what declining levels of trust in state institutions imply for informality, corruption and low levels of interpersonal trust.

Russia constitutes a vivid example of a society in which state failure creates alternative sources of trust in society. What is meant by state failure is the inability of state institutions to deliver services to citizens in an impersonal manner in accordance with the rule of law. One vivid example of such state failure is the case of wage payments. The social capital survey conducted in Russia, found out that less than two in five people receive the wage or pension to which they are entitled (Rose, 2000:154). State pensions, one of the most indispensable responsibilities of the modern state, are even more likely to be paid late. In such a context, the people are obliged to compensate the inefficiencies of the bureaucratic system by de-bureaucratizing and personalizing previously formal relationships. Rose argues that organizational failure in the Russian context is not necessarily a sign that nothing works but that organizations in general and state institutions in particular do not work according to the logic of a modern state characterized by equal access and impersonal service delivery. If such a situation arises individuals invoke a variety of informal social capital network to get things done (Rose, 2000:159). Some of these anti-modern tactics that Russians have to utilize are begging or cajoling officials to get a certain service from the state such as begging officials to admit person to hospital or keep demanding action at social security office to get paid. Another tactic is using connections to get an official to bend and break the rules. Paying cash money to officials for a service that a normal citizen should be entitled for free is another method. The break-down of extensive social security services provided during communism, also brought the break-down of the faith in the state as a trustworthy institution towards which citizens should fulfill their responsibilities. In the New Russia Barometer Survey conducted in

1998, 56 % of the Russians expressed that there is no need to pay taxes, 77 % believe a cash payment to a tax-official would be enough to evade taxes (Rose, 2000:158).

Another vivid example of how state performance can affect the levels of trust comes from Kumlin and Rothstein's (2003) work about the impact of state on social capital in Sweden. They challenge the commonly held assumption that when people are protected from the cradle- to- the -grave by a strong welfare state, their associational life will be crowded-out. Contrary to the belief that when social obligations become public, intimate ties will weaken between citizens, they argue for the opposite by claiming that well-functioning political institutions have positive effects on citizen's willingness to comply and cooperate in society. They propose that citizen's trustworthiness and law abiding nature is not affected by the vibrancy of associational life but it is rather determined by the perceived performance of democratic and bureaucratic institutions (Kumlin and Rothstein, 2003:5). Their starting point is the procedural justice involved in citizen's relations with state institutions. Procedural justice is concerned with whether the individual was received with respect and dignity, whether he/she was able to communicate opinions to the civil servants and if the services in question was delivered devoid of discrimination and corruption (Kumlin and Rothstein, 2003:11). The legitimacy of the political system depends on the extent to which this procedural justice is achieved. But, what is the relation between interpersonal trust and procedural justice? Their answer is the following:

“First, people may make inferences about others' trustworthiness from how they perceive public bureaucrats. If social workers, policemen, public health workers etc. act in such a way that they cannot be trusted, nor can people in general be trusted. Secondly if most people in order to get what they themselves deem necessary from the public services, because of how the system operates, usually engage in distorting vital information (cheating) and other forms of dishonest behavior then the logical inference is that most people cannot be trusted. Thirdly, if you yourself have to engage in this sort of dishonest behavior then people like you cannot be trusted thus the inference made is that neither the people in general should be trusted” (Kumlin and Rothstein, 2003:13).

They test the validity of this hypothesis in the case of one of the most trusting societies in the world, Sweden. Sweden also matches the criteria of the work since it is a country with big government with universal welfare services. They prove in line with the procedural justice argument, that universality and impersonal nature of welfare state in

Sweden fosters trust. Their claim is that the road to a more solidaristic society goes through creating a system of institutions which makes people interdependent, such as the case of a fair taxation system where every citizen contributes to a pool of resources from which the public in general and the needy in particular benefit. In such a setting reciprocity and fairness will become formal behaviors in those roles. In such a system, trust in other people can be defined as the confidence with which we expect others to be constrained by the duties and requirements attached to their roles (Mistral, 1998:226-227). In Sweden, state is able to collect 98 % of the taxes as opposed to 26 % in Russia (Uslaner and Badescu, 2004a:7).

By claiming that trust in state can be increased by making the proper institutional ameliorations, trust is endogenized. In other words, it is turned into a dependent variable. This approach can be traced back to scholars such as Coleman (1988) and Granovetter (1985) who explicitly embedded social capital in a rational-choice model, which resembles the recent institutional approaches which try to identify conditions under which trust can be generated.

Taking trust as a rather predetermined trait makes it exogenous hence independent of social changes and political engineering. The exogenous-endogenous distinction is not a picayune interest for social scientists, as the answer to this question has important policy implications. If, for example trust is a stable and predetermined variable then a policy effort such as decreasing corruption in the name of increasing trust in state so that people will be more willing to pay their taxes is a dream. Uslaner (2004a) although having modified some of his views about institutional capacity in changing levels of trust, argues against the claims of Rothstein on the grounds that trust is the determining factor in creating the healthy institutional set-up of Scandinavian countries. He proposes that trust in legal system in Sweden does not breed interpersonal trust; it is the other way round. Swedes and other Westerners can develop strong legal systems because people trust each other (Uslaner and Badescu, 2004a:3).

Secondly and contrary to our initial arguments about the correlation between trust and corruption, he argues that people are more likely to link their perceptions of trust with

corruption in countries where there is rule of law, accountability and transparency. In countries such as post-communist ones, where such attributes are lacking, corruption is widespread at the societal level so interpersonal trust is highly unlikely to be affected from perceptions about corruption (Uslaner and Badescu, 2004a:4). Corruption and informality are a way of life for them, hence people would not be too harsh about others engaged in such activities. In Uslaner's words: "When it is all around you, you do not bother yourself too much" (Uslaner and Badescu 2004a:10).

With this theoretical background in mind, there are two roads to approach the issue of informality. One can interpret informality as reaction to state intrusion in economic affairs due to low levels of solidarity. As has been pointed out by many scholars, large informal economy is a sign that people have little faith in the government's ability to manage the economy and little faith in other citizens beyond their immediate family (Uslaner and Badescu, 2004b:13). When there is disbelief in state capacity to make the economic life better, people do not want intrusion into their economic affairs. A possible attempt to legalize informality is difficult because of this high mistrust between state and society. The informality can only shrink "...if the individual understands the necessity of an infringement of personal freedom,.....declares his solidarity with society and perceives the benefits of the state as being sensible" (Schneider and Enste, 2002:183).

However, there is another interpretation that is quite different from the one above. Informality is a way of life for countries where corruption is the norm. As long as people can get their fair share from such practices, nobody will be too harsh about others engaged in similar activities. Especially when the fish rots from the head, that is those institutions that are supposed to guide and regulate the economic activities of the citizens, are themselves prone to corruption, there is no way of blaming the citizenry for being distrustful. They just adapt themselves into this web of favoritism. In the next section I will search for a design to find an answer this question.

In short, I have two propositions to test in the ensuing analyses: The first proposition is that in those countries where there is widespread corruption, we expect to see large informal sector; e.g. there is a positive relationship between corruption and informality. The

second proposition is that in countries where there is widespread informality we do not automatically have low levels of trust in state as long as people get their fair share from this practice. In that sense low levels of trust in state institutions are not necessarily the determining indicators of low tax morale and large informal sector. There may be many factors behind low levels of confidence in state institutions and trying to link confidence with informality means stretching the trust literature too much.



CHAPTER 3: METHODOLOGY

I will adopt a cross-sectional mode of analysis using data from the period 1997 to 2003 for a total of 55 countries. All variables used in my analyses are not available for all countries and for all years. Accordingly, I use different years for different variables. However, since the variables I use are more likely to remain more or less of similar values for the period of analysis I take this as a minor shortcoming given the data constraints. To test the validity of my claims, I will use the following variables:

Confidence in legal system, police, government and civil service will be used to calculate the overall trust in state institutions. Variables such as GNP per capita, Employment Laws Index, Cost to Register a Business, Bureaucratic Quality Index, Overall fiscal burden and Property Rights Index are control variables that I included into the equation to overcome biasedness. The only determinants of informal sector are not corruption and confidence, there has to be certain macroeconomic and policy-wise determinants that we equally have to account for. It has usually been stated by economists that bureaucratic regulations such as tax rates, employment laws, bureaucratic obstacles during registering a business, the protection of private property (patents, royalties included) and overall bureaucratic quality are equally important in the determination of the size of informality. In this work, I will try to find out which one(s) of these variables turn out to be more important and determining.

Table 1: The List of Variables

<u>Variable Name</u>	<u>Source</u>	<u>Year</u>	<u>Notes</u>
Size of Informal Sector	The work of Friedrich Schneider titled "Size and Measurement of the Informal Economy in 110 Countries Around the World" a July 2002 working paper available at www.worldbank.org	2000	Calculated as a percentage of GNP. For the methodology, see the source cited.
Corruption Perceptions Index	Corruption Perceptions Index (CPI) of Transparency International available at www.transparency.org	2003	Countries are ranked according to the perceived levels of corruption calculated by independent (non-governmental) organizations. The index varies between 1 and 10. 10 means absence of corruption whereas 1 marks its total prevalence.
Confidence in legal system (as a % of total population)	World Values Survey downloaded from www.worldvaluessurvey.org	1997	Question No: 137 of World Values Survey is "Do you have confidence in the legal system of your country? 1. great deal 2. quite a lot 3. not very much 4. none at all." I took the total percentage shares of items 1 and 2 as an indicator of confidence
Confidence in police (as a % of total population)	World Values Survey downloaded from www.worldvaluessurvey.org	1997	Question No: 141 of World Values Survey is "Do you have confidence in the police of your country? 1. great deal 2. quite a lot 3. not very much 4. none at all." I took the total percentage shares of items 1 and 2 as an indicator of confidence
Confidence in government (as a % of total population)	World Values Survey downloaded from www.worldvaluessurvey.org	1997	Question No: 142 of World Values Survey is "Do you have confidence in the government of your country? 1. great deal 2. quite a lot 3. not very much 4. none at all." I took the total percentage shares of items 1 and 2 as an indicator of confidence

<u>Variable Name</u>	<u>Source</u>	<u>Year</u>	<u>Notes</u>
GNP per capita in \$ (PPP)	Downloaded from www.nationmaster.com , the real source is CIA World Fact Book	2003	
Employment Laws Index (0=less rigid, 100=very rigid)	World Development Indicators. The original methodology and data come from The Regulation of Labor, by Juan Botero, Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Sila at www.worldbank.org	2003	This statistic is an average of "Regulation - Hiring", "Regulation - Firing", and "Regulation - Employment Conditions". Nations are listed with an Employment Laws Index between 1 and 100. The higher the index, the more the nation regulates Employment
Cost to register a business (% of business revenue)	World Development Indicators and World Bank, Doing Business project (http://rru.worldbank.org/DoingBusiness/)	2003	"Costs to register a business" is normalized by presenting it as a percentage of gross national income (GNI) per capita.
Bureaucratic quality index	International Country Guide of Political Risk Analysis Group at www.prsgroup.com	2003	An index between 1 and 4 where higher scores are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services. Bureaucracy tends to be autonomous from political pressure and has an established mechanism for recruitment and training.
Overall fiscal burden index	Index of Freedom of Heritage Foundation at www.heritage.org	2004	An index between 1 and 5 where lower scores mean less tax burden on corporations and individuals. This index is a weighted average of scores for top marginal income tax rate (weight=25%), top marginal corporate tax rate (weight=50%) and change in government expenditure as a % of GNP (weight=25%)
Property rights index	Index of Freedom of Heritage Foundation at www.heritage.org	2004	An index between 1 and 5, where lower scores mean a higher respect for property rights. This factor scores the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws.

In testing the effect of the selected independent variables on the size of informal sector, a multiple regression model will be utilized. This model will be constructed in a step by step fashion however I do not use a stepwise regression specification. First macroeconomic and fiscal policy determinants will be put into the equation. After assessing their explanatory capacity, the major trust indicators will be added to the model . Lastly those countries whose informal sector size is hard to estimate with the regression equation i.e.outliers will be excluded so as to get a better explanatory capacity with the regression equation at hand. It is true that with the inclusion of every new independent variable the number of countries for which the relevant data exist will decrease. This is mainly due to the fact that many of the indicators of the above table come from different sources calculated for differing number of countries. At the start of the analysis my equation has 55 observations. However, at the end of this step by step expansion of the model the number of observations drops down to 36.

Table 2: Descriptive Statistics of Independent Variables

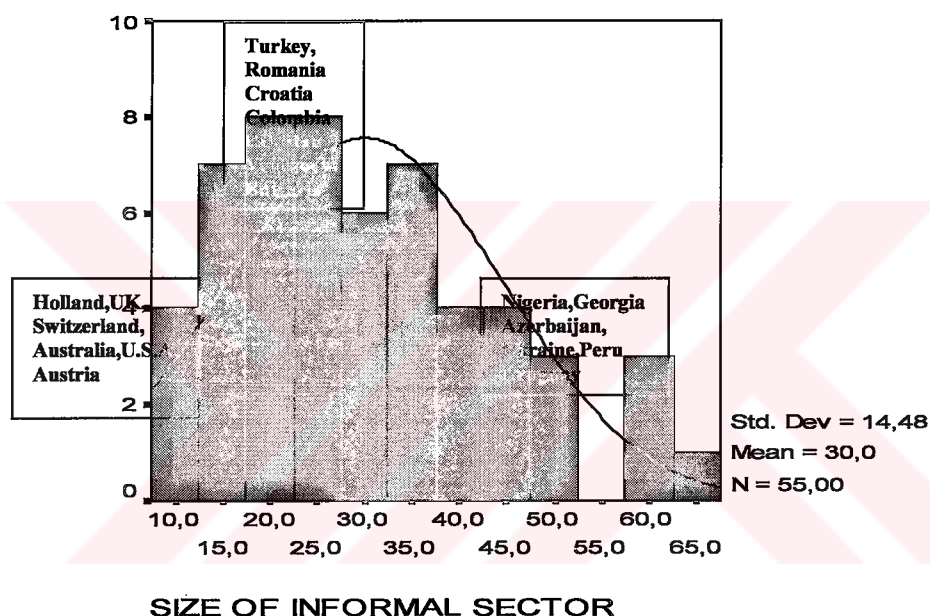
	N	Minimum	Maximum	Mean	Std. Deviation
Size of Informal Sector (% of GNP)	55	8,8	67,3	29,99	14,48
Corruption Perceptions Index	55	1,2	10	4,91	2,5
Bureaucratic Quality Index	51	1	4	2,77	1,04
Overall fiscal burden	55	1,8	4,4	3,49	0,68
Property rights index	55	1	5	2,69	1,23
GNP per capita in \$ (PPP)	55	840	35991	13908,62	10481,97
Confidence in Legal System	53	14,4	85,9	51,45	15,9
Confidence in Police	53	12	89,2	53,39	20,17
Confidence in Government	47	12	93,7	47,56	17,07
Confidence in Civil Service	47	7,9	96,8	47,34	16,02
Employment Laws Index	54	22	79	52,98	14,33
Cost to Register a Business (% of GNI per capita)	54	0	112	21,96	23,06
Valid N (listwise)	36				

Here it will be useful to make a more substansive description of the properties of our independent variables.

1. Size of Informal Sector

As it is shown in Table 1, the mean value for the size of informal sector as a percent of GNP is approximately 30 percent. The lowest informal sector size belongs to USA with a 8,8 percent and the highest informal sector size belongs to Georgia with 67,3 percent.

Figure 1: Histogram of Size of Informal Sector



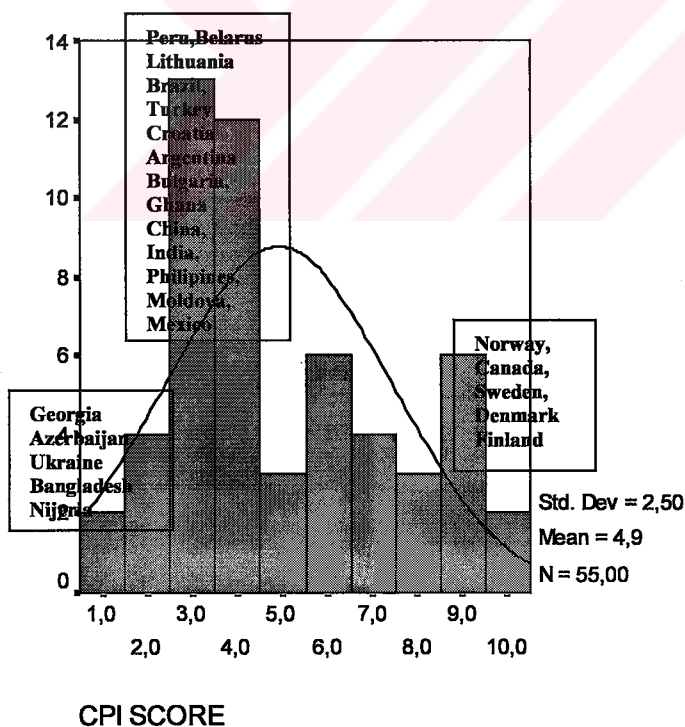
For an illustration of the variation in the informal sector size, some of the countries for the intervals of 0-15 %, 25-35 % and 50-70 % are plotted on the diagram. As can be observed from the histogram, informal sector size smaller than 10 % and bigger than 60 % are rare cases, however as the histogram is right skewed, it is harder to observe informal sector size for values bigger than 60%. The majority of the cases gather around the interval 15 % and 35 % which covers 36 countries out of 55 observations. Nevertheless, there is still too much dispersion in the data since standard deviation is half the size of the mean value. There is the possibility of coming across countries with 15 % of GNP and 45 % of GNP within one standard deviation from the mean. The interesting fact about the distribution of informal sector size is that the smallest informal sector size belongs to

OECD countries whereas largest informal sector size is observed in post-communist countries such as Georgia, Armenia and Azerbaijan which still struggle to establish a stable and strong state with clear frontiers. This means that informality is more likely to exist in countries where the sovereignty of the state and the rule of law are not instituted in the real meaning of the term. In that sense, state sovereignty and a stable political regime seem to be the prerequisites for a healthy functioning, rule-abiding economy.

2. Corruption Perceptions Index (CPI) Score

As had been explained before, CPI score has a range between 1 and 10, the higher the score the less corrupt a society is. Only Finland achieved 10, in 2003 CPI rankings.

Figure 2: Histogram of CPI score



In our survey, the mean value is approximately 5, which is a moderate score (meaning that it indicates neither too much corruption nor much transparency) but if one

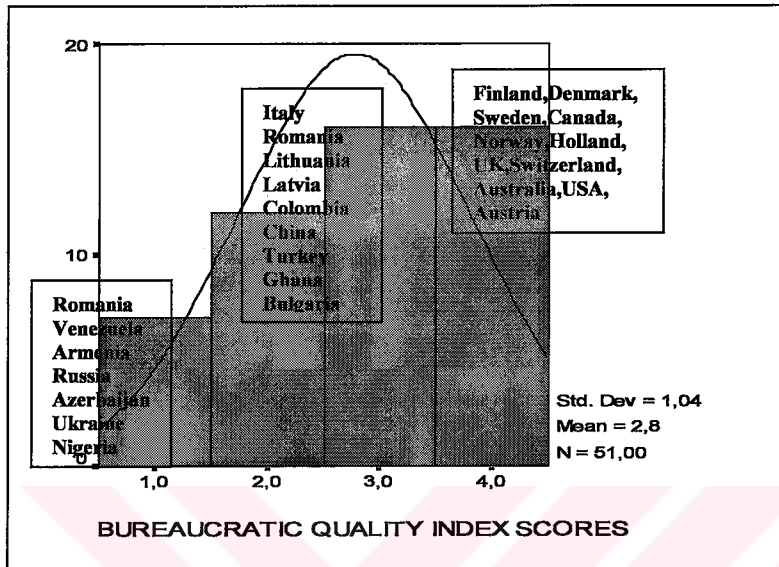
looks at the distribution of the scores the number of countries above the average score (which is 5) is 21, while the ones below the average is 32, which means more corrupt societies dominate our observations. For a better illustration, I put sample countries for CPI score intervals 0-2 and 2,5-4,5 and 9-10. The 0-2 and 9-10 intervals are outliers, while 2,5-4,5 interval is the most populous, which again confirms that more corrupt societies are dominant in my sample.

Although the values are mainly lower than 5, there is still significant dispersion in the dataset to claim any homogeneity across countries. Standard deviation is half the size of the mean and within one standard deviation there are both very low and very high CPI scores. What strikes the attention is the crowding of the lowest values of CPI index by post-communist countries and some developing countries. The highest values are achieved by Northern European countries (Scandinavian countries mainly).

3. Bureaucratic Quality Index

Bureaucratic quality ranges between 0 and 4. Achieving a higher score in the bureaucratic quality index implies a more efficient administration. The mean value of my sample is 2,8 which is above an average performance (I take the middle value 2, as average). Those countries that achieved 1, 2 and 4 are plotted on the histogram for observation. Notice that those countries that achieved 1 are outliers. There are only 7 countries with the score of 1. Notice that many of the top ranking bureaucracies are OECD or developed countries, while poor performers are developing and post-communist. It is not surprising that those countries that achieved low levels of corruption and informality are also the ones with a better bureaucratic quality.

Figure 3: Histogram of Bureaucratic Quality Index

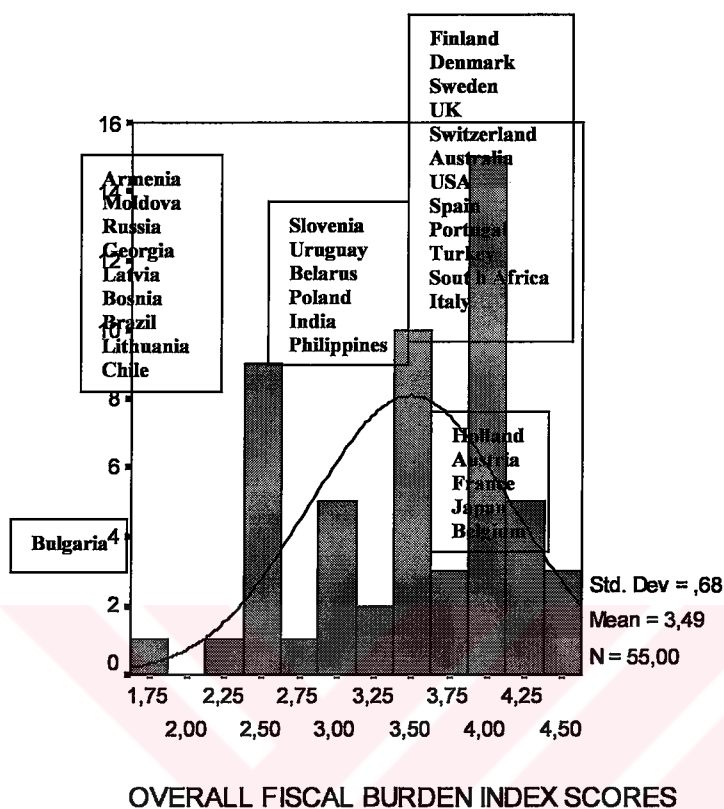


If one remembers the proposition that lower levels of corruption is only possible with a healthy functioning bureaucracy (look at page 16), it will not be hard to predict why the same countries appear for the lowest values in informal sector size and corruption levels and high bureaucratic quality. Only an impartial bureaucracy can manage with corruption and tax evasion and only in this way the informality can be kept at a minimum.

4. Overall Fiscal Burden Index

The overall tax burden index is within the range of 1 to 5, where higher scores mean higher tax burden.

Figure 4: Histogram of Overall Fiscal Burden

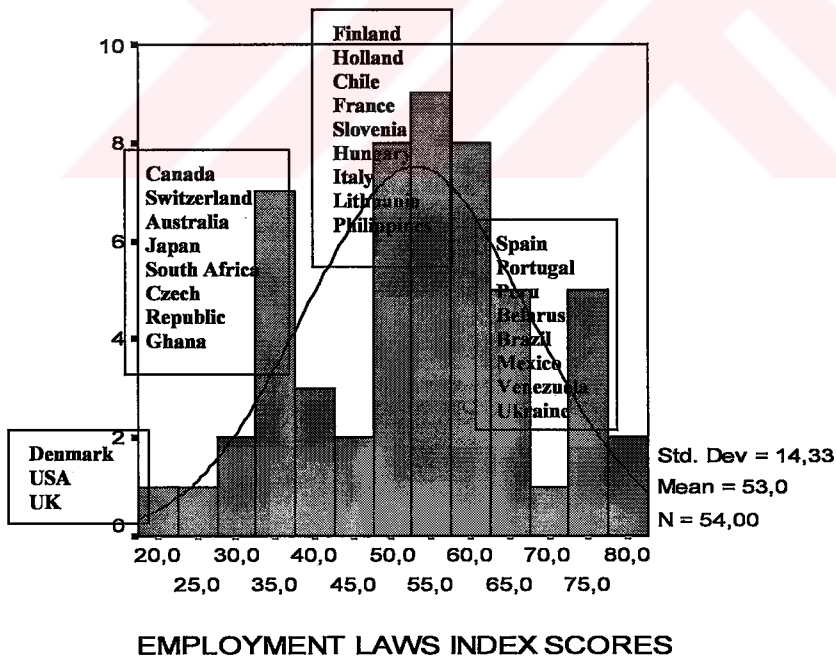


There is an observable trend in the overall fiscal burden data. There may be developing countries whose overall tax burden is comparable to that of developed countries, but usually the top tax rates, hence overall tax burden are higher for advanced economies of the world. The lower the tax burden, the lower the economic potential of the country. This fact is important in the sense that, it is usually claimed by economists that higher tax rates are responsible for larger informality, as firms and individuals can not cope with high tax rates, they opt for informality. Yet, the majority of high tax burden countries are OECD countries which also have the lowest informal sector size. This implies a new challenge to standard economic theory. The findings of the regression analysis will shed more light on this fact.

5. Employment Laws Index

As explained before, the higher the employment laws index (from 0 to 100), the more rigid are the laws governing hiring, firing and employment conditions. The mean of this index turns out to be 53 (which is neither too rigid nor too lax). The majority of cases gather around values of 45-65. The countries with the most relaxed employment conditions are quite exceptional; only three countries exhibit such lax regulation. Notice that welfare states where employment conditions are considered as quite strict and protective do not rank as high as some of the developing countries on the right end of the distribution. Most of the developing world rank high on employment laws index. Notice that the developing world also ranks high on the size of informal sector. In that sense, the strictness of employment conditions can be an impediment on the growth of formal economy.

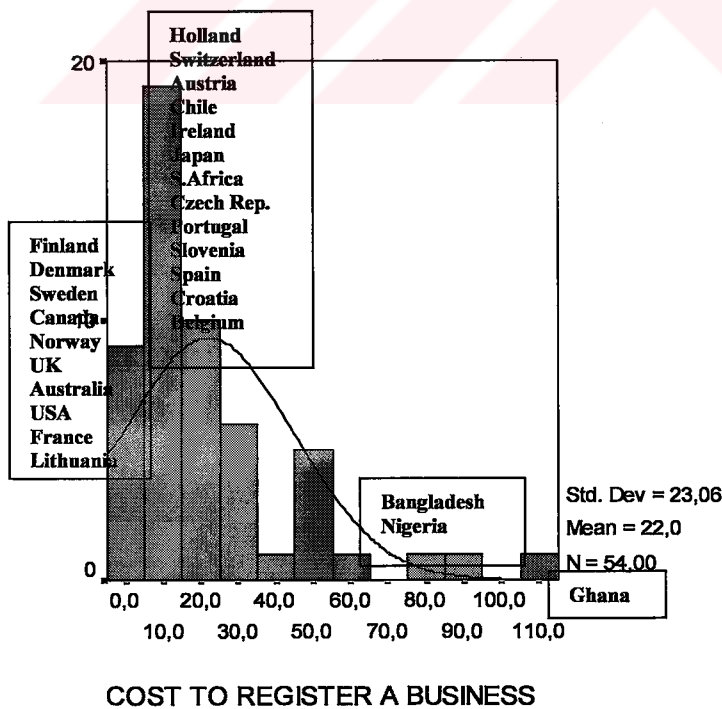
Figure 5: Histogram of Employment Laws Index



6. Cost to Register a Business (as % of GNI per capita)

For this indicator, there are countries varying between 0 (Denmark) to 112 (Ghana). We can still claim that cost to register a business is rather small for the sample we have at hand. The mean value is 22 and most of the values are one standard deviation below the mean which means much of the values center around 0-22 range. For an illustration, countries for the values 0-5 and 10-20 and 80-90 and 100-112 are put on the histogram. Notice that most of the developed countries are at the left hand-side, which means they have lower costs to register a business. There is a parallel between bureaucratic quality and cost to register a business. In countries where bureaucracy is qualified and efficient, entrepreneurs do not spend too much time, resource and energy in trying to deal with the red-tape, they are given the necessary aid by bureaucracy to increase their investments and research. In that sense in countries where there is high bureaucratic quality (mostly OECD countries) we can also observe lower costs to register a business.

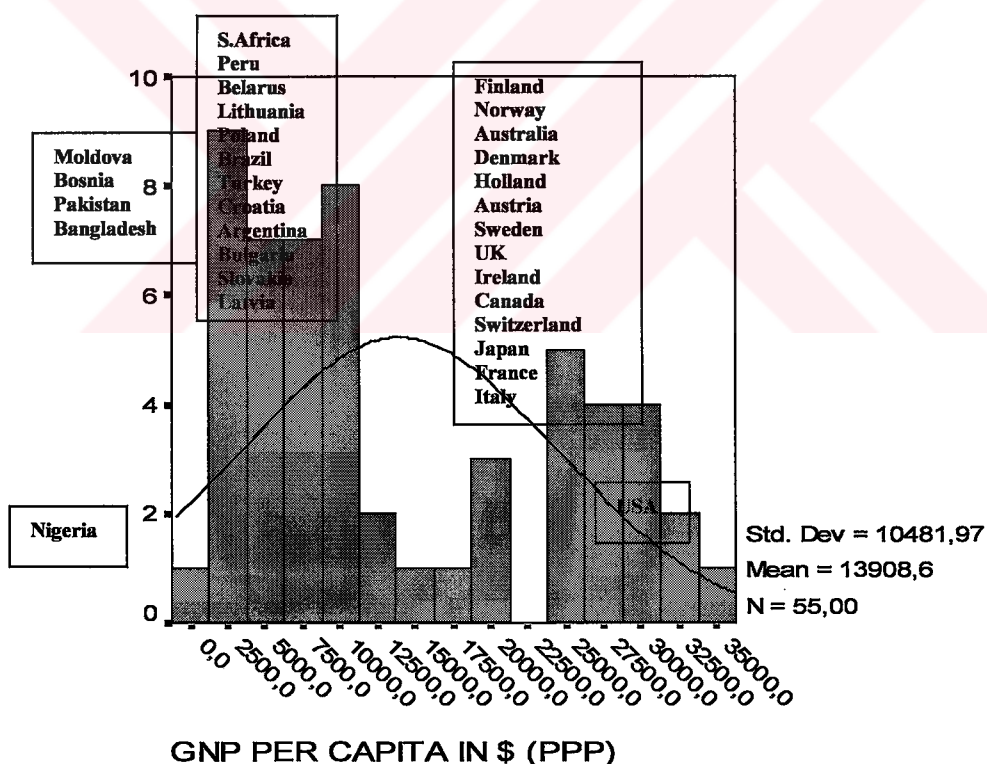
Figure 6: Histogram of Cost to Register a Business



7. GNP per capita in \$ (PPP)

The mean GNP per capita in purchasing power parity (PPP) is \$13908 which is approximately equal to that of Hungary (\$13339) The examples on the plot belong to smaller than \$1000, \$1500-2500, \$ 5000-12500 and \$ 22500-32500 ranges. The mean value is quite high due to the high GNP per capita levels in developed countries. If you look at the distribution of countries there are more low to medium income level countries than there are high income countries. This fact is even more evident if you take the value of standard deviation into account. Within one standard deviation (\$10481), we have very low income levels around \$3000 to very high income levels around \$24000.

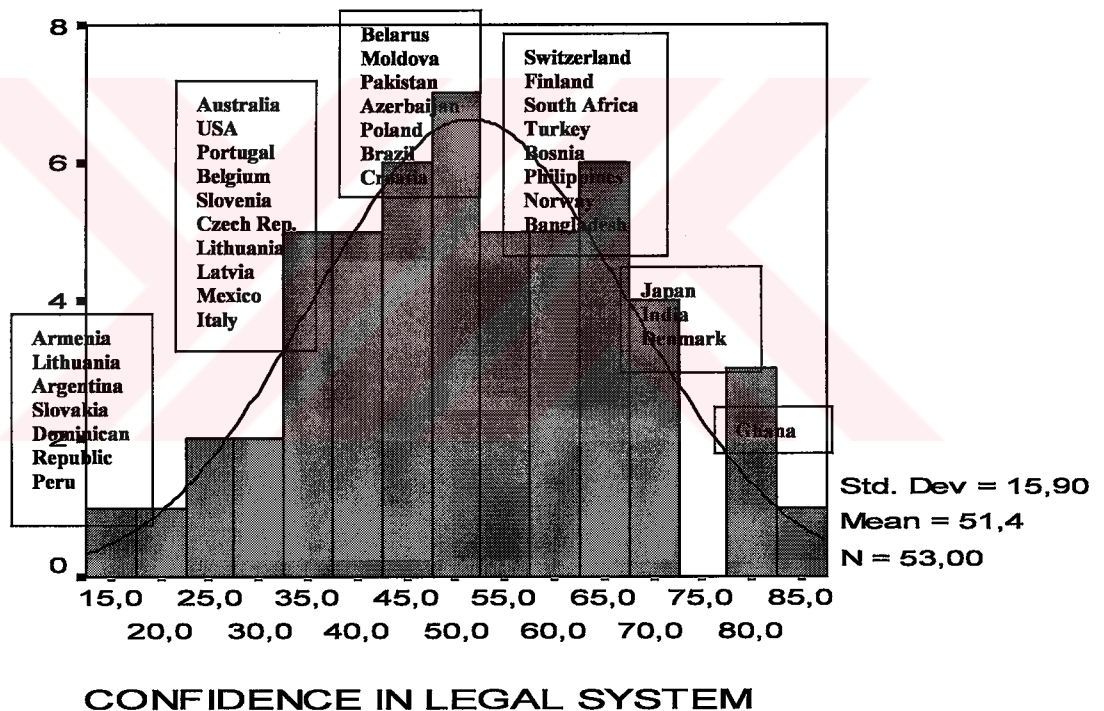
Figure 7: Histogram of GNP per capita in \$ (PPP)



8. Confidence in Legal System

Histogram of Confidence in Legal System exhibits the percentage of people trusting their legal system across countries. Confidence in Legal System exhibits more or less a normal distribution where the values to the right and the left of the mean are almost equally distributed. The mean is 51 % of people having confidence in legal system

Figure 8: Histogram of Confidence in Legal System



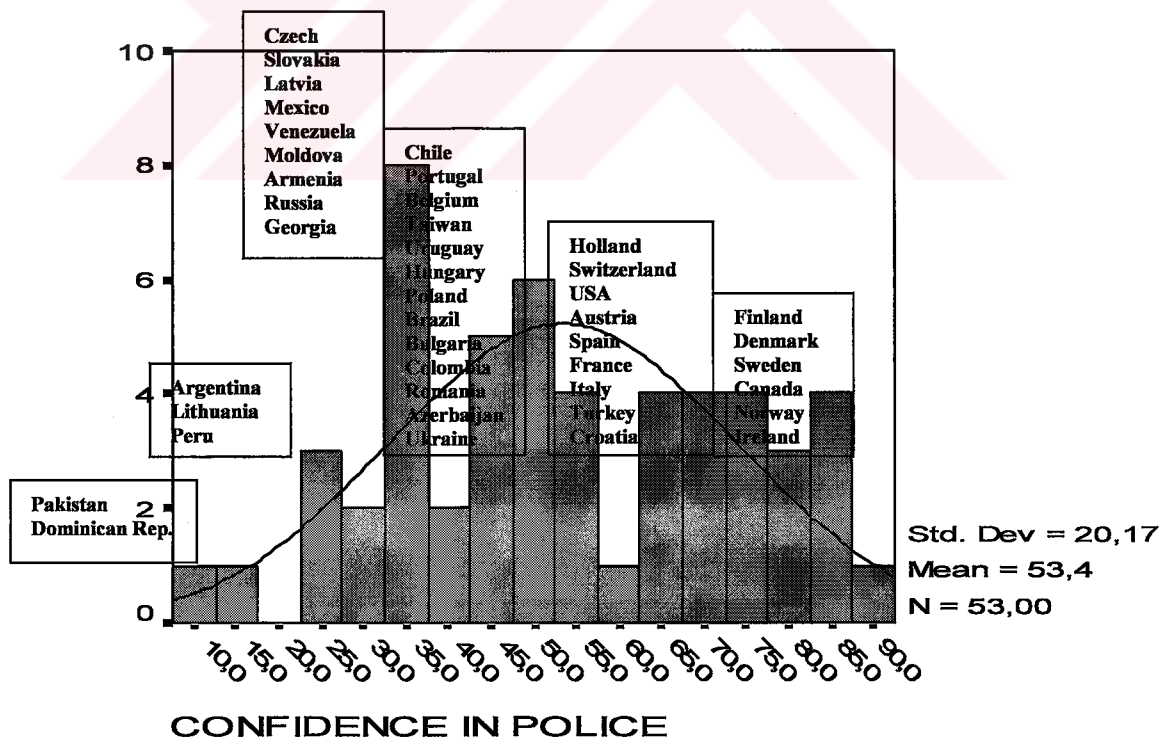
. Notice that the countries at the left extreme (around the values of 15 %) are low income countries with relatively big informal sector size. Nevertheless, we are not in a position to claim that higher level of confidence in legal system is a property of developed-high income countries. There as many developing countries, as there are developed countries to the right of the spectrum. (i.e. The most confident country is Ghana) The distribution and the shape of confidence in legal system does not support claims such as higher levels of

trust in state institutions lowers informality. Many developing countries have high trust in their legal systems comparable to that of developed countries, yet they also have high informality.

9. Confidence in Police

The poorer countries tend to dominate lower levels of confidence in police in the histogram. The developed countries (mostly Scandinavian), on the other hand, dominate the right hand side of the histogram. The mean value is 53%, yet the values are highly dispersed. The value of standard deviation is nearly half of the mean value. There is not much skewness implying that countries with high or low levels of trust do not dominate the data set..

Figure 9: Histogram of Confidence in Police

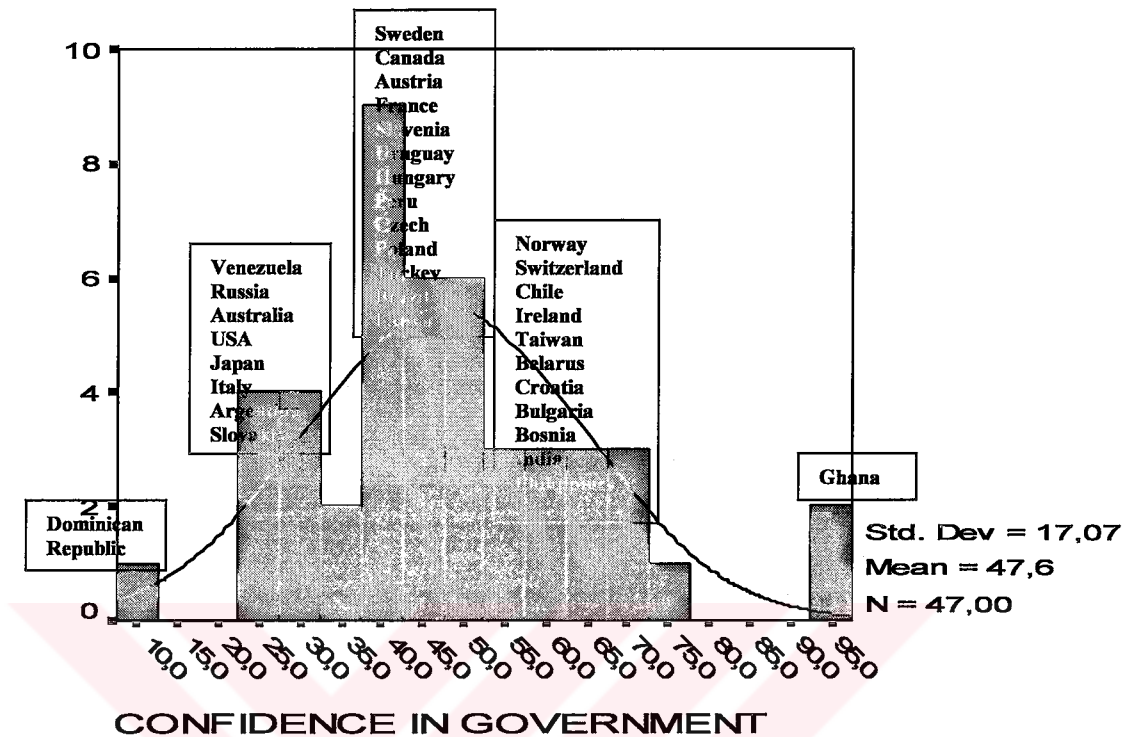


The findings of the confidence in police and confidence in legal system are somehow different. In the latter, there was not a clear link between the level of development and confidence. In this case however, developed countries show significantly higher levels of trust in police than the developing world. This may be due to the fact that, the primary public servants that people are mostly in contact with are the policemen. In that sense the attitudes about legal system may be shaped by very ambiguous criteria, while attitudes about police are much more solid and factual. In developing countries where grievances are more harshly suppressed than the more developed democratic world and where police is more prone to corruption due to economic scarcity, the negative perceptions about police as the chief symbol of the legitimate violence of the state is more striking

10. Confidence in Government

The mean value for confidence in government is a below average value of 47 % (if one takes 50 % as average). In the case of confidence in government, higher levels of trust in government is not associated with a particular development level. There are wealthy, and relatively stable countries (without much macroeconomic crisis, and with better economic management) that are at the lower end of the spectrum i.e Japan, USA, Australia. By the same token, countries such as India, Bosnia and Philippines can rank as good as Switzerland and Norway and even better than Sweden, France or Austria, which proves that confidence is a relative term, from which many people may understand different things especially when they do not have the means to compare their country with other ones. In the case of confidence in government, economic well being is just one factor which is not the sole criteria to predict the levels of trust in state.

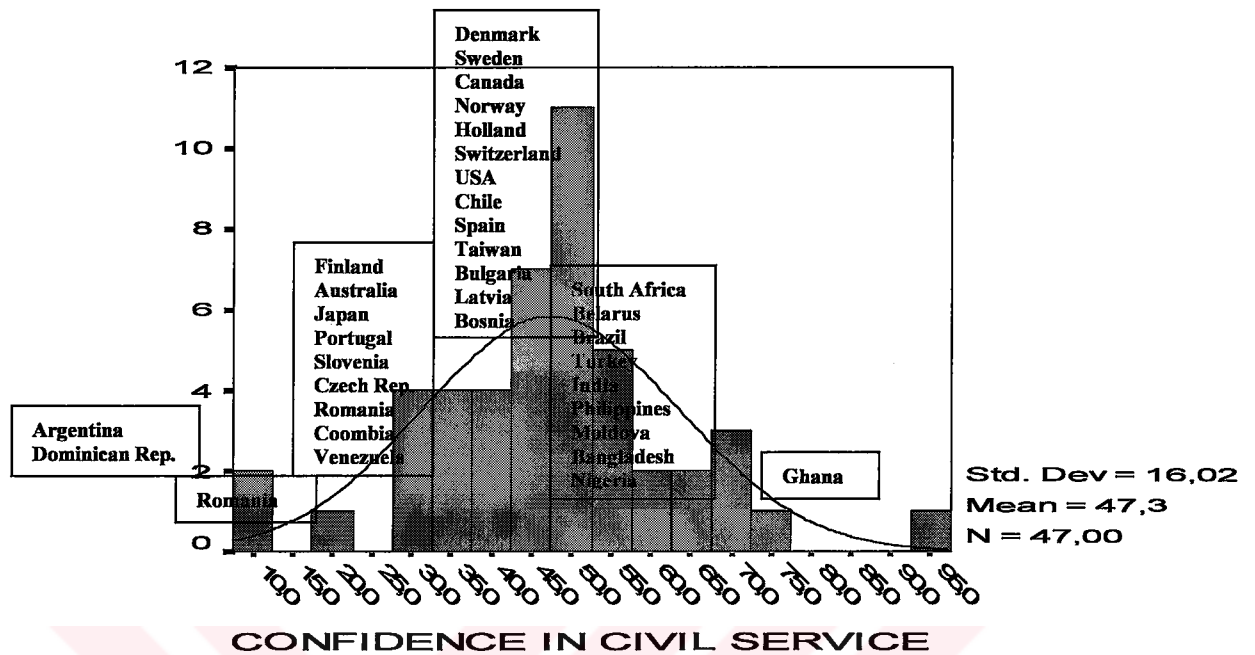
Figure 10: Histogram of Confidence in Government



11. Confidence in Civil Service

The observations we made about confidence in civil service are true for confidence in civil service. Higher levels of confidence in civil service is not associated with a particular development level. There are wealthy, and relatively stable countries with modern bureaucracies that are at the lower end of the spectrum i.e Japan, Finland and Australia, along with Romania or Colombia. By the same token, countries such as Bulgaria and Latvia classify as good as many Scandinavian countries, which again proves that confidence is a relative term, from which many people may understand different things especially when they do not have the means to compare their country with other ones.

Figure 11: Histogram of Confidence in Civil Service



There are certain variables that should be used to create new composite variables since they are the indicators of the same concept. There is also the danger of severe multicollinearity in the case of using these variables together that reduces their individual significance. Accordingly, CPI score and bureaucratic quality variables will be reduced into one composite variable called 'bureaucratic impartiality'. The reason for the significance of multicollinearity is the following: A bureaucratic quality index is used to distinguish countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services. In those countries where bureaucracy tends to be autonomous from political pressure and has an established mechanism for recruitment and training one also expects to see less corruption. That is why there is a big correlation between these two variables.

Table 3: Total Variance Explained With Factor Analysis for CPI score and Bureaucratic Quality

	Communalities	Factor Loadings	% of Variance
	Extraction		91,92
CPI score	0,92	0,96	
Bureaucratic Quality	0,92	0,96	

New variable name: Bureaucratic impartiality

92 % of the total variance in the two variables at hand can be explained by the new composite variable. The factor loadings for the two variables show that both variables are highly correlated with the newly created latent variable (96 %) that is called 'bureaucratic impartiality'.

I also put all the confidence variables into one factor variable since I want to explain trust in state institutions as a whole.

Table 4: Total Variance Explained With Factor Analysis for Confidence Indicators

	Communalities	Factor Loadings	% of Variance
	Extraction		67,42
Confidence in Legal System	0,847	0,920	
Confidence in Police	0,475	0,684	
Confidence in Government	0,617	0,785	
Confidence in Civil Service	0,748	0,865	

New variable name: Confidence in public institutions

The new composite variable explains 67 % of the total variance. The factor scores or the weights given to legal system, police, government and civil service are 92 %,68 %,78 & and 86 % respectively showing that all four variables are highly correlated with the newly created latent variable.

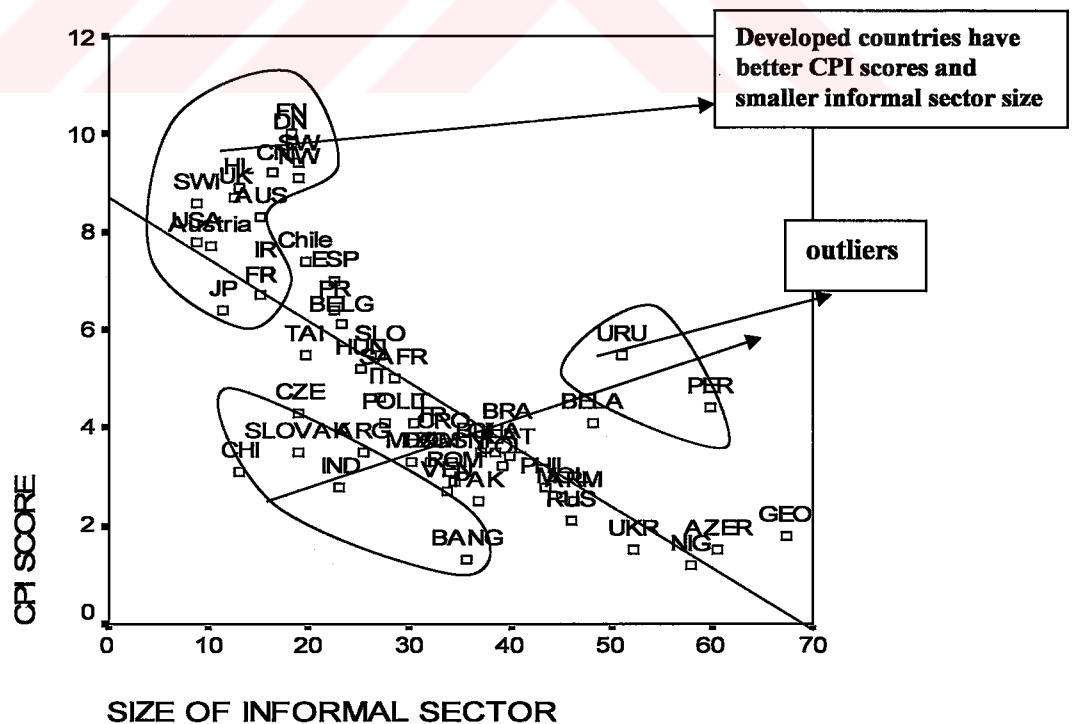
CHAPTER 4: FINDINGS

Here are the one to one relationship of informal sector with independent variables, on scatter plots.

1. Size of Informal Sector and Corruption Level

The size of informal sector is bigger for countries with higher levels of corruption. This is a finding that I have been emphasizing from the beginning. Informality cannot exist without the deliberate negligence of state officials, which is confirmed by the data at hand.

Figure 12: Size of Informal Sector and Corruption Level



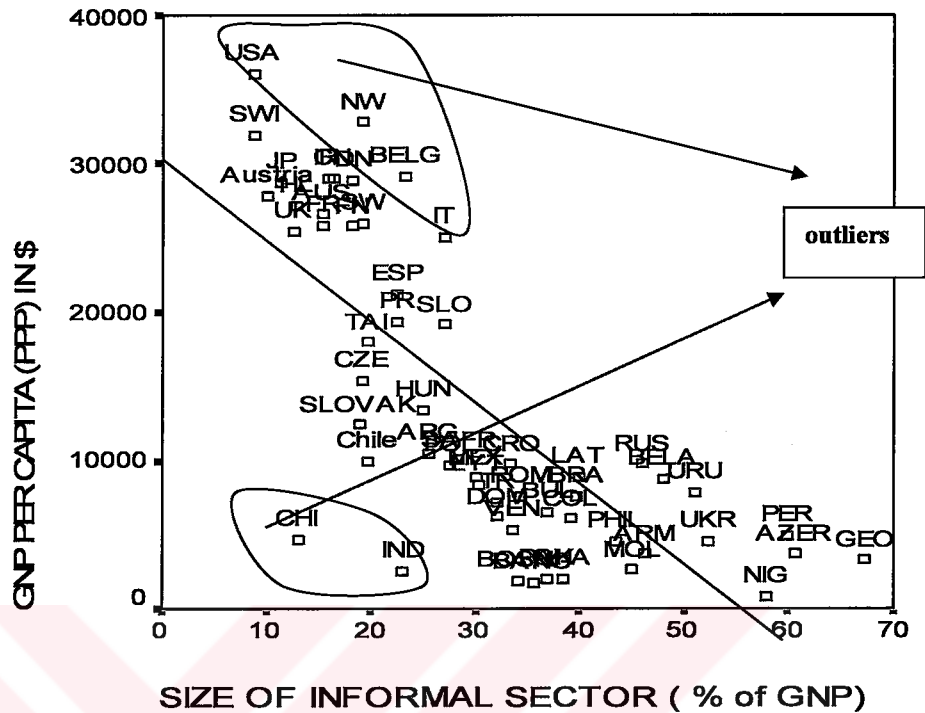
Nevertheless, there are certain outliers in the data that do not fit the expected trend. Those countries that are significantly below the fit line such as China, Bangladesh, India and Slovakia exhibit lower levels of informality in comparison to their CPI score. Conversely, those countries above the fit line i.e. Uruguay, Belarus and Peru show higher levels of corruption in comparison to their informal sector size. In a similar vein, Scandinavian countries that achieved scores around 10 have higher informal sector size in comparison to their CPI score. Notice that the upper left corner of the fit line is crowded by developed countries (mostly OECD), while lower right corner is filled with developing and transition economies.

2. Size of Informal Sector and GNP per Capita (PPP)

There is an expected trend in the relationship between GNP per capita and informality. For those countries where GNP per capita is low, informal sector tends to get bigger. In those countries where GNP per capita is low poverty is a more acute problem and people endure worse working conditions for the sake of earning a living, which is a gateway to informality.

There are certain outliers that have to be mentioned. Those countries that are well above the fit line such as USA, Norway, Belgium and Italy, have bigger informal sectors in comparison to their GNP per capita. Also notice that many of the developed countries are gathered around the upper left corner of the graph. Those outliers that are below the fit line such as China and India have smaller informal sectors than expected.

Figure 13: Size of Informal Sector and GNP per Capita (PPP)

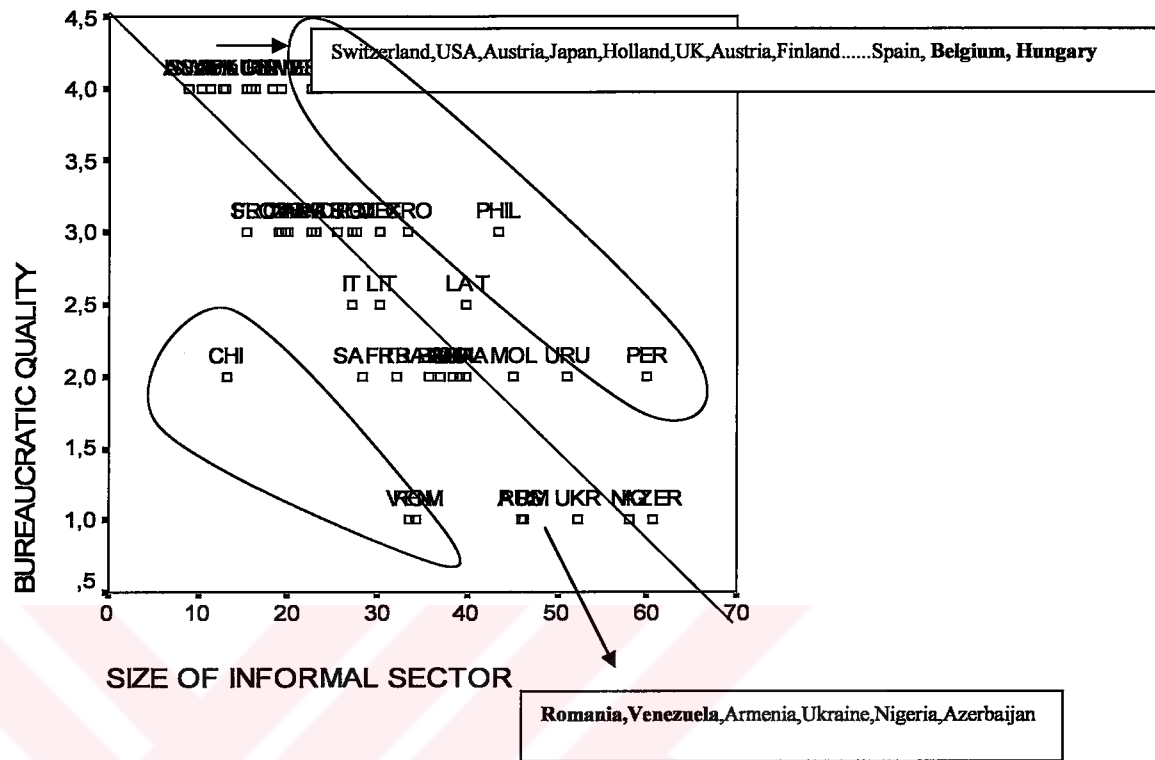


3. Size of Informal Sector and Bureaucratic Quality Index

Size of informality and bureaucratic quality are inversely proportional. Yet, at the same bureaucratic quality level, there is large variance of the size of informality for different countries. The other independent variables of the multiple regression equation will account for the difference in size of informality for the countries at the same bureaucratic quality level.

There are certain outliers that I want to mention. Those countries above the fit line have higher levels of informality in comparison to the honesty of their bureaucracies i.e. Spain, Belgium, Peru and Philippines, whereas those below the line have lower levels of informality in comparison to the flaws in their administrative functioning. i.e China, Romania and Venezuela. Notice that all of the developed countries have low informality, high institutional capacity combination as the upper left corner of the line reveals.

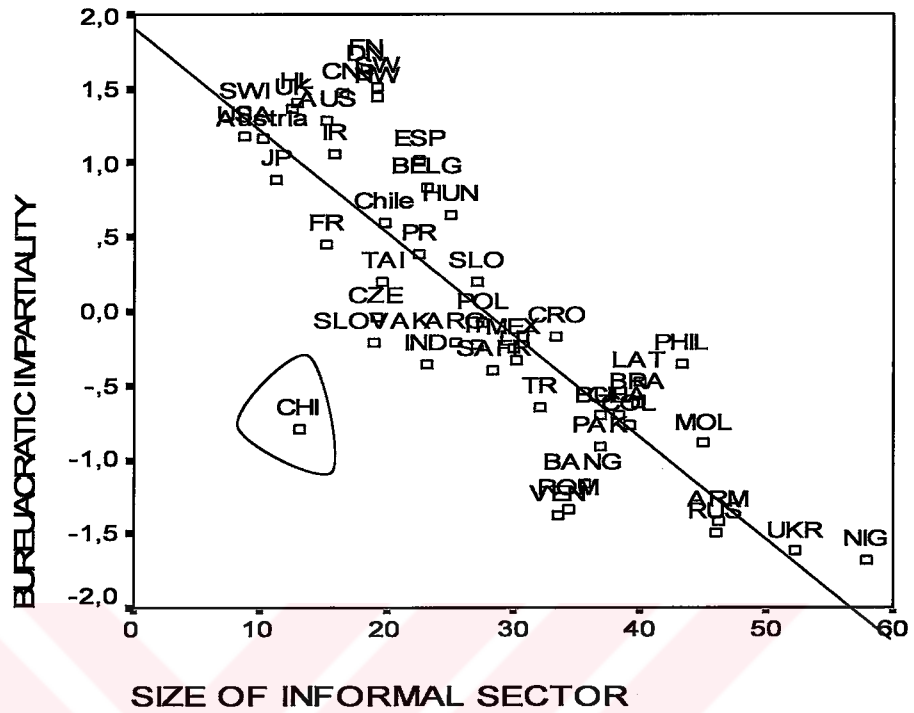
Figure 14: Size of Informal Sector and Bureaucratic Quality Index



4. Size of Informal Sector and Bureaucratic Impartiality

The composite variable of Bureaucratic Impartiality derived from the factor analysis of CPI score and Bureaucratic Quality Index also has a very significant relationship with the size of informal sector. There is not much outlier except for China. It has a clear pattern. As bureaucratic impartiality increases informality shrinks. Notice that many of the OECD countries are above the fit line at the left hand side which implies they are at a low informality-high bureaucratic quality point.

Figure 15: Size of Informal Sector and Bureaucratic Impartiality

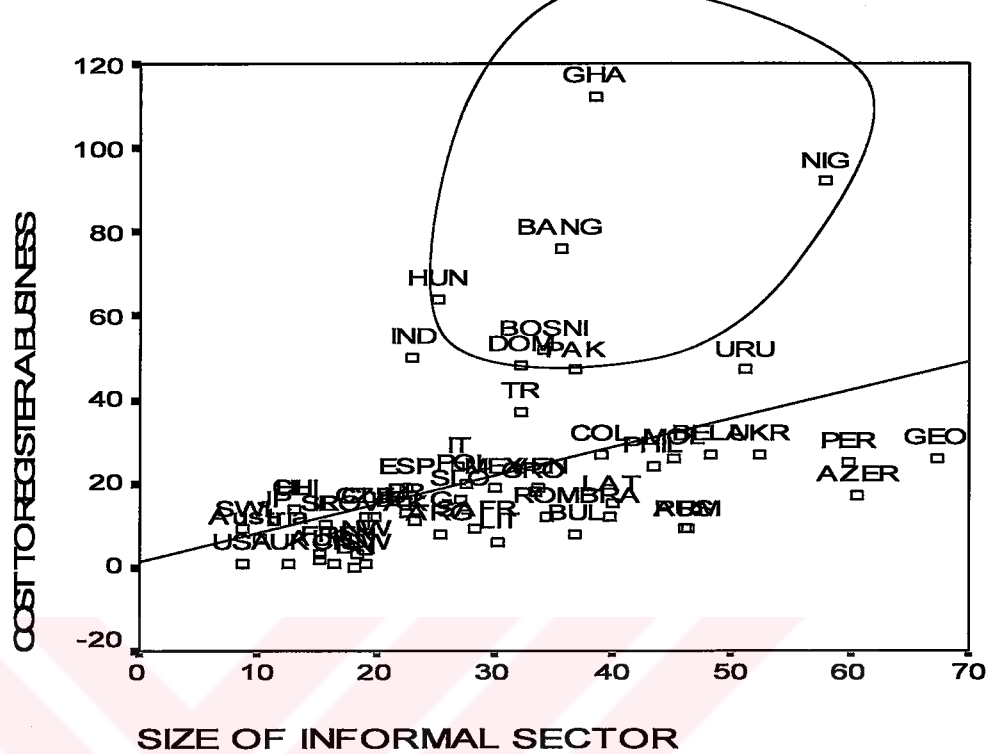


5. Size of Informal Sector and Cost to Register a Business

Cost to register a business is in direct proportion with the size of informality as it is revealed from the plot. The higher the costs of staying a formal business, the more will the enterprises opt for saying informal.

There is not much outlier except for China. It has a clear pattern. As bureaucratic impartiality increases informality shrinks. Notice that many of the OECD countries are above the fit line at the left hand side which implies they are at a low informality-high bureaucratic quality point.

Figure 16: Size of Informal Sector and Cost to Register a Business



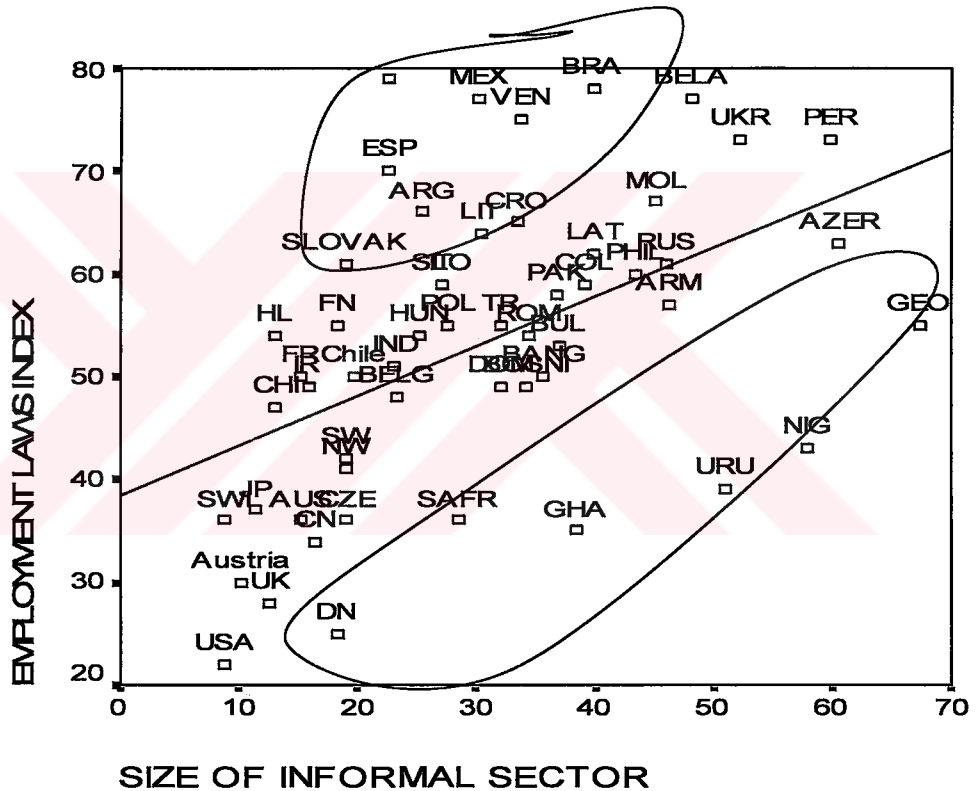
Although much of the observations gather around the fit line, there are many outliers that have no consistent relationship with the remaining countries. In fact, if I excluded those outliers from the sample, the fit line would look quite flat, implying that there is not a very significant relationship between the cost to register a business and size of informal sector.

In the following plots, there is no significant pattern in the relationship between size of informal sector and the independent variable. To be noted is the absence of any correlation between confidence in state institutions and informal sector size. I will return to this finding when I deal with the results of my multiple regression model.

6. Size of Informal Sector and Employment Laws Index

Although there is a positive relationship between employment laws index (as the index increases, the regulation becomes more rigid, working conditions more under scrutiny) and informality. Both increase in the same direction. Yet, there is too much variation in the data to claim a perfect fit. The outliers -especially below the fit line - put limits to claims about a strong correlation.

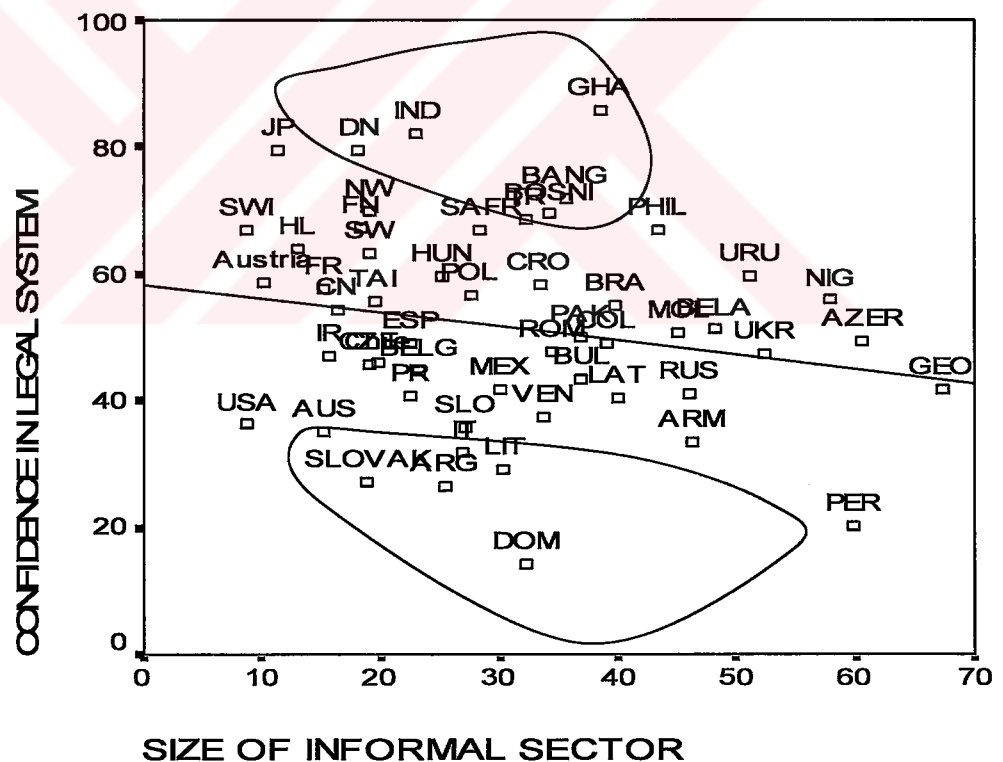
Figure 17: Size of Informal Sector and Employment Laws Index



7. Size of Informal Sector and Confidence in Legal System

There is a slight negative correlation between informality and confidence in legal system. The correlation is slight because there is too much dispersion in the data. For the same value of informal sector size, the countries below the fit line have lower levels of trust in legal system, while for those above the levels of trust in legal institutions are higher than expected. While most of the developing countries show a mixed result in terms of confidence in legal system, (if one looks below and above the line, in every corner there is a possibility to find a developing country), except for USA, Australia and Italy, many of the developed countries are either close to the fit line or above the line.

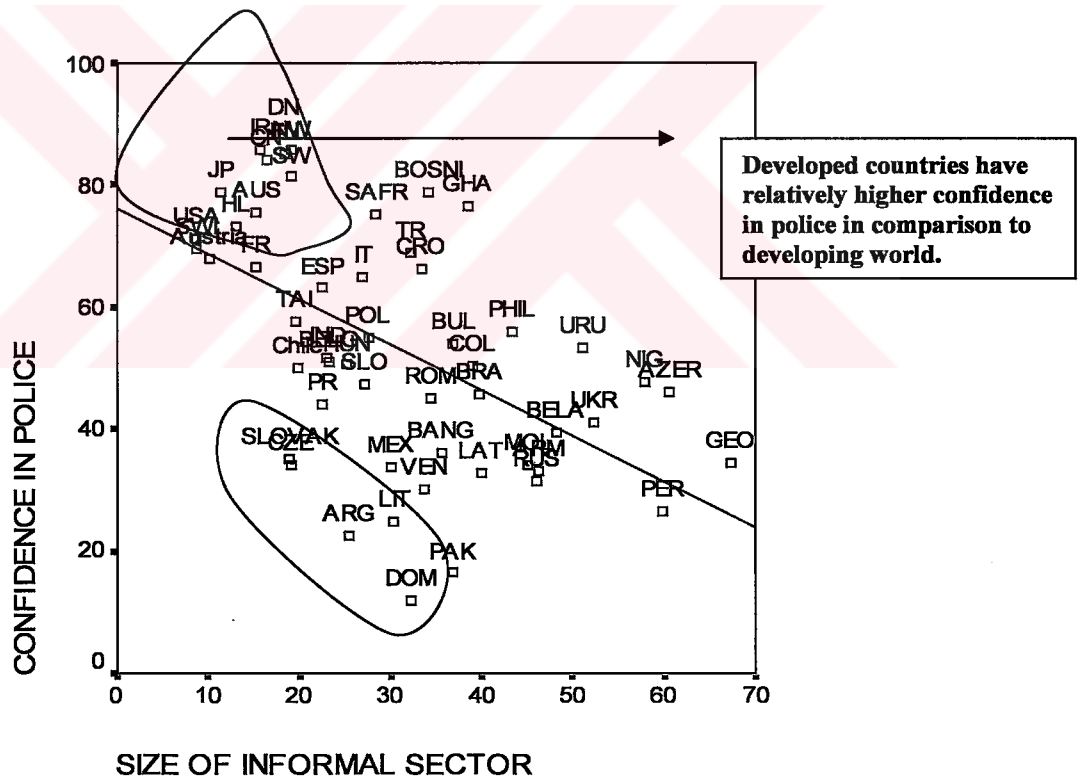
Figure 18: Size of Informal Sector and Confidence in Legal System



8. Size of Informal Sector and Confidence in Police

There is a negative relationship between size of informal sector and confidence in police. Many developing countries are scattered around the fit line, either above or below, while almost all of the developed countries are above the upper left corner of the fit line, which means that developing countries show mixed results in terms of confidence in police, while developed countries have higher levels of trust. There are certain outliers i.e. Dominican Republic, Pakistan Argentina, Lithuania, Czech Republic and Slovakia, all well below the fit line which have lower levels of confidence in police in comparison to their informal sector size.

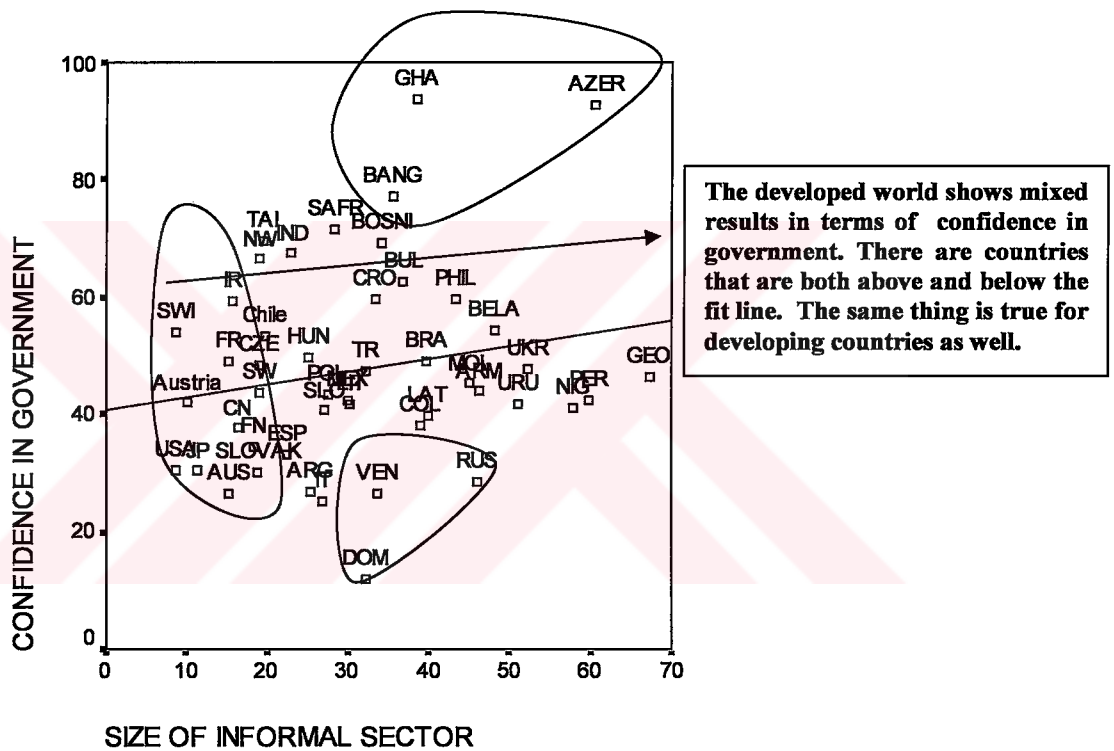
Figure 19: Size of Informal Sector and Confidence in Police



9. Size of Informal Sector and Confidence in Government

The correlation is rather awkward in this scatter plot. It seems as if the more there is confidence in government the bigger the informal sector. The data is too scattered and the slope is rather small to claim a powerful relationship. There are many outliers i.e. Dominican Republic, Bangladesh, Ghana and Azerbaijan that disprove the correlation.

Figure 20: Size of Informal Sector and Confidence in Government

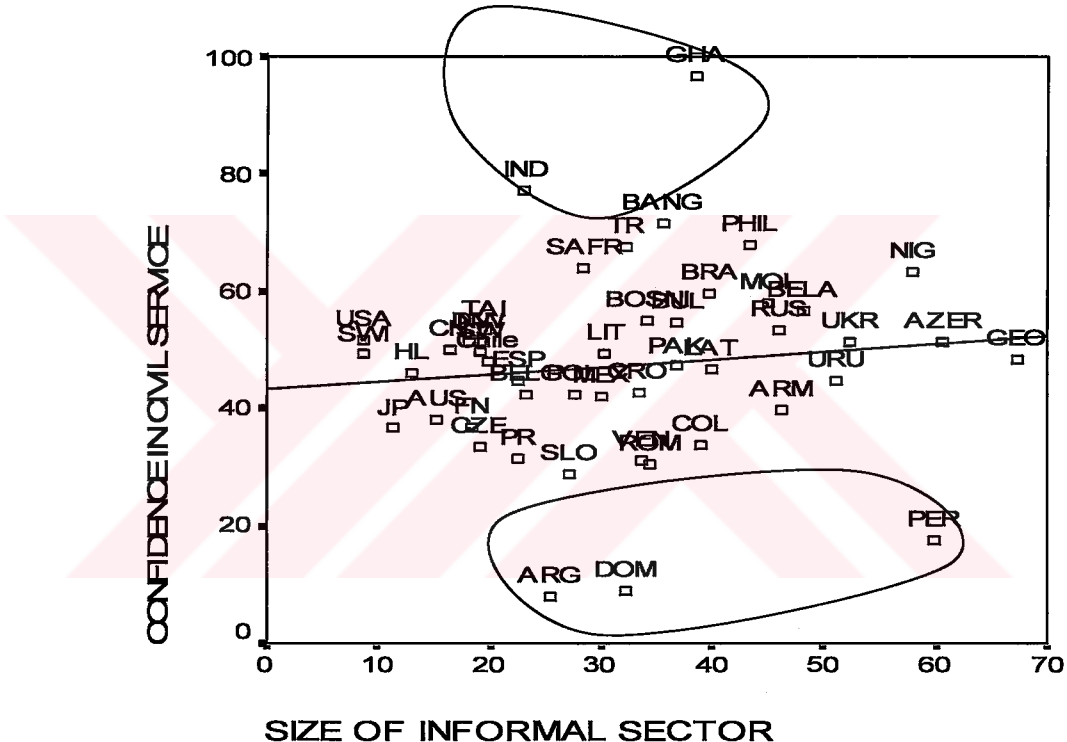


10. Size of Informal Sector and Confidence in Civil Service

As the confidence in civil service drops, the size of informality is getting smaller which is a finding unanticipated. Again, the data is very scattered with many outliers and the slope is rather small to claim a strong correlation. The developing and the developed

countries show mixed results. I am not in a position to claim that high levels of trust in civil service and low levels of informality are a specific feature of developed countries. Despite the fact that developed countries are situated at the left hand-side, which means they have low levels of informality, trust in civil service is rather varying, they move below and above the fit line. Developing countries, on the other hand have both varying degrees of confidence and size of informality.

Figure 21: Size of Informal Sector and Confidence in Civil Service

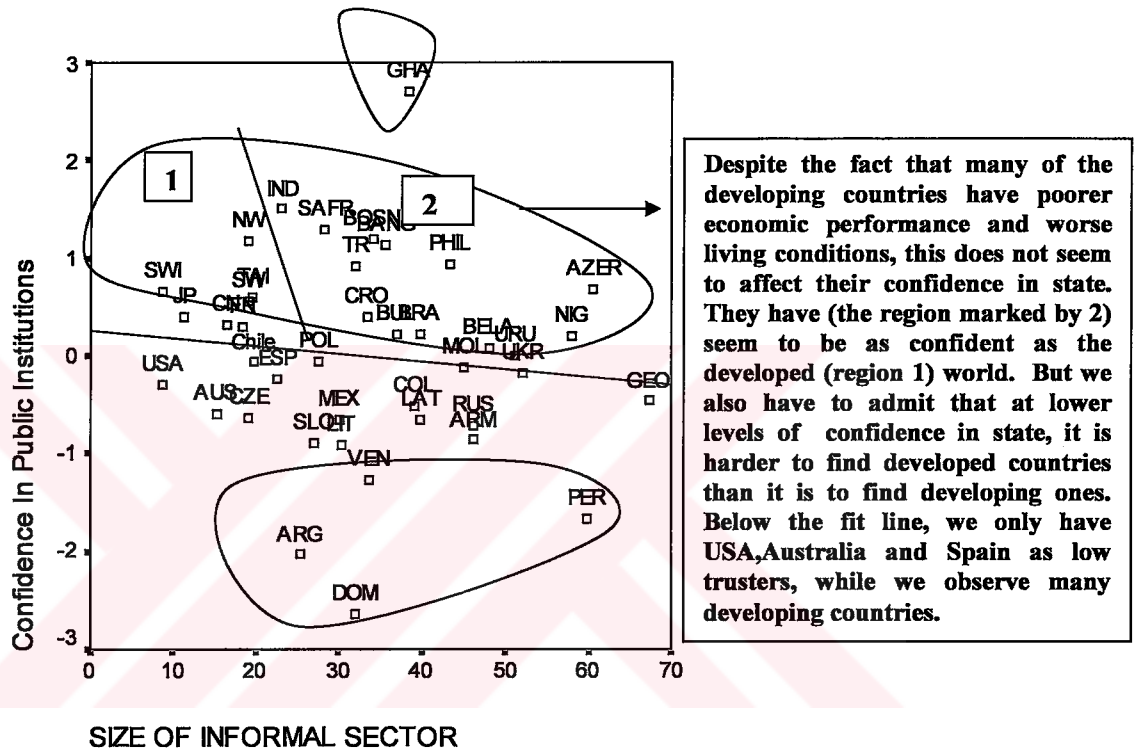


11. Size of Informal Sector and Confidence in Public Institutions

The direction of the correlation is as expected. As the confidence in public institutions decreases the informal sector size increases. Yet, the slope is too small to claim any powerful relationship. There is not a particular trend about confidence in public

institutions among the developed or the developing world. Despite the fact that developing countries have bigger informal sector size, their levels of confidence in public institutions are comparable to that of the developing world. This proves that confidence in public institutions does not result from overall economic performance or wealth creation.

Figure 22: Size of Informal Sector and Confidence in Public Institutions



12. The Design of Multiple Regression

The initial design of the regression equation included three dummy variables, based on the income groupings of the countries, namely high income group, upper income group, lower income group and low income group¹⁴ As the coefficient table reveals as the income level drops from high to upper income, size of informal sector increases by 13,1, as it drops

¹⁴ The list of income groups is available as an appendix at the end of the chapter

from upper to lower it increases by 9,08 (22,18-13,1), as it drops from lower to low it increases by 5,07 (27,11-22,18). This is consistent with the hypothesis that prevalence of informality is very much related to and caused by low income and poverty.

Table 5. Regression Equation According to Income Levels

Dependent Variable: SIZEOFIS	Unstd. Coefficients		Std. Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	17,22	2,23			7,73	0
Upper Income	13,1	3,55	0,39		3,69	0
Lower Income	22,18	3,55	0,66		6,25	0
Low income	27,11	4	0,7		6,78	0

R Square	Adj. R Square	F	Std. Error of the Estimate
0,55	0,53	21,06	9,96

¹⁵The explanatory capacity of the dummies revealed by the Adjusted R square is 0,53. Now I have to test the explanatory capacity of GNP per capita and decide on which variables to include into the equation. Since both GNP and income dummies test the levels of income, I will pick the indicator with the better explanatory capacity.

Table 6. Regression Equation With GNP per capita substituted for Income Levels

Dependent Variable: SIZEOFIS	Unstd. Coefficients		Std. Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	44,48	2,16			20,57	0
GNPPER	-0,00104	0	-0,75		-8,37	0

R Square	Adjusted R Square	Std. Error of the Estimate	F
0,57	0,56	9,59	69,98

The explanatory capacity of GNP per capita is higher than the dummies as revealed by the adjusted r square. So I take GNP per capita as our initial independent variable. Now I include the other macroeconomic variables at hand.

Table 7. Regression Equation With Major Macroeconomic and Fiscal Policy Determinants

Dependent Variable: SIZEOFIS	Unstd. Coefficients		Std. Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	33,3	11,14			2,99	0,01
GNP per capita	-0,00004	0	-0,04		-0,15	0,88
Overall Fiscal Burden	-3,32	1,97	-0,16		-1,69	0,1
Property Rights Index	-0,71	2,56	-0,06		-0,28	0,78
Employment Laws Index	0,15	0,1	0,15		1,41	0,17
Cost to Register a Business	0,11	0,07	0,19		1,62	0,11
Bureaucratic Impartiality	-8,67	3,09	-0,63		-2,8	0,01

R Square	Adjusted R Square	Std. Error of the Estimate	F
0,7	0,66	8,1	16,74

Adjusted R square increased significantly with the inclusion of the new variables (from 0,56 to 0,66). Yet, the only significant variable is bureaucratic impartiality. Now I include the confidence indicators.

Table 8. Regression Equation With the Inclusion of Confidence in Public Institutions

a Dependent Variable: SIZEOFIS	Unstd. Coefficients		Std. Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	29,76	13,09			2,27	0,03
GNP per capita	0,00	0	0,04		0,16	0,88
Overall Fiscal Burden	-3,39	2,52	-0,16		-1,34	0,19
Property Rights Index	-0,08	2,87	-0,01		-0,03	0,98
Employment Laws Index	0,18	0,15	0,18		1,15	0,26
Cost to Register a Business	0,12	0,1	0,21		1,27	0,21
CPI score & bureaucratic quality	-9,31	3,92	-0,66		-2,37	0,03
Confidence in Public Institutions	-0,52	1,94	-0,03		-0,27	0,79

R Square	Adjusted R Square	Std. Error of the Estimate	F
0,74	0,67	8,2	11,15

As a last step I exclude the outliers which are two standard deviations away from the estimates of our regression line. The descriptives of the outliers are given below, along with the final regression equation.

Table 9. The Descriptives of the Outliers

Case Number	COUNTRY	Std. Residual	SIZEOFIS	Predicted Value	Residual
24	Peru	2,4	59,9	40,24	19,66
51	Uruguay	2,13	51,1	33,6	17,5

Table 10. The Last Regression

Dependent Variable: SIZEOFIS	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	20,87	10,22			2,04	0,05
GNP per capita	0,00	0	0,3		1,27	0,22
Overall fiscal burden	-3,33	1,88	-0,17		-1,77	0,09
Property Rights Index	0,12	2,24	0,01		0,05	0,96
Employment Laws Index	0,25	0,12	0,26		2,12	0,04
Cost to Register a Business	0,05	0,07	0,1		0,75	0,46
CPI score & bureaucratic Quality	-12,25	3,03	-0,94		-4,04	0
Confidence in Public Institutions	2,61	1,58	0,18		1,66	0,11

R Square	Adjusted R Square	Std. Error of the Estimate	F
0,84	0,79	6,1	19,16

For values of $p=0,10$ Overall fiscal burden (Sig=0,09), Employment Laws Index (Sig=0,04), and CPI score & Bureaucratic Quality (Sig=0) are the significant variables that have a meaningful effect on the size of the informal sector. The overall explanatory capacity of the model is 79 % .

Table 11. Residuals for the Estimated Regression Line

COUNTRY	Actual value (Size of Informal Sector)	Predicted Value	Residual	Residual %
Finland	18,3	13,56	4,74	0,35
Sweden	19,1	10,88	8,22	0,76
Canada	16,4	13,92	2,48	0,18
Norway	19,1	15,69	3,41	0,22
Switzerland	8,8	16,3	-7,5	-0,46
Australia	15,3	10,1	5,2	0,52
USA	8,8	11,51	-2,71	-0,24
Chile	19,8	21,59	-1,79	-0,08
Spain	22,6	20,69	1,91	0,09
Japan	11,3	17,47	-6,17	-0,35
Slovenia	27,1	27,4	-0,3	-0,01
South Africa	28,4	29,65	-1,25	-0,04
Czech Republic	19,1	22,3	-3,2	-0,14
Lithuania	30,3	34,24	-3,94	-0,12
Poland	27,6	28,4	-0,8	-0,03
Brazil	39,8	43,89	-4,09	-0,09
Turkey	32,1	36,85	-4,75	-0,13
Croatia	33,4	34,79	-1,39	-0,04
Argentina	25,4	26,58	-1,18	-0,04
Bulgaria	36,9	40,56	-3,66	-0,09
Ghana	38,4	39,11	-0,71	-0,02
Latvia	39,9	36,2	3,7	0,1
Mexico	30,1	32,59	-2,49	-0,08
Colombia	39,1	33,4	5,7	0,17
India	23,1	33,7	-10,6	-0,31
Philippines	43,4	34,22	9,18	0,27
Venezuela	33,6	42,11	-8,51	-0,2
Moldova	45,1	42,81	2,29	0,05
Armenia	46,3	44,59	1,71	0,04
Russia	46,1	48,39	-2,29	-0,05
Azerbaijan	60,6	49,49	11,11	0,22
Ukraine	52,2	48,94	3,26	0,07
Nigeria	57,9	46,73	11,17	0,24
Bangladesh	35,6	42,34	-6,74	-0,16

The residual statistics exhibit few outliers at both extremes i.e.Switzerland and India, on the minus side, Sweden and Australia on the plus side. Many of the countries gather around the residual interval -0.13 % to 0.13 %. There is more of overestimation, since the countries to the left of 0 are more crowded.

Figure 23.Histogram of Residuals (in %)

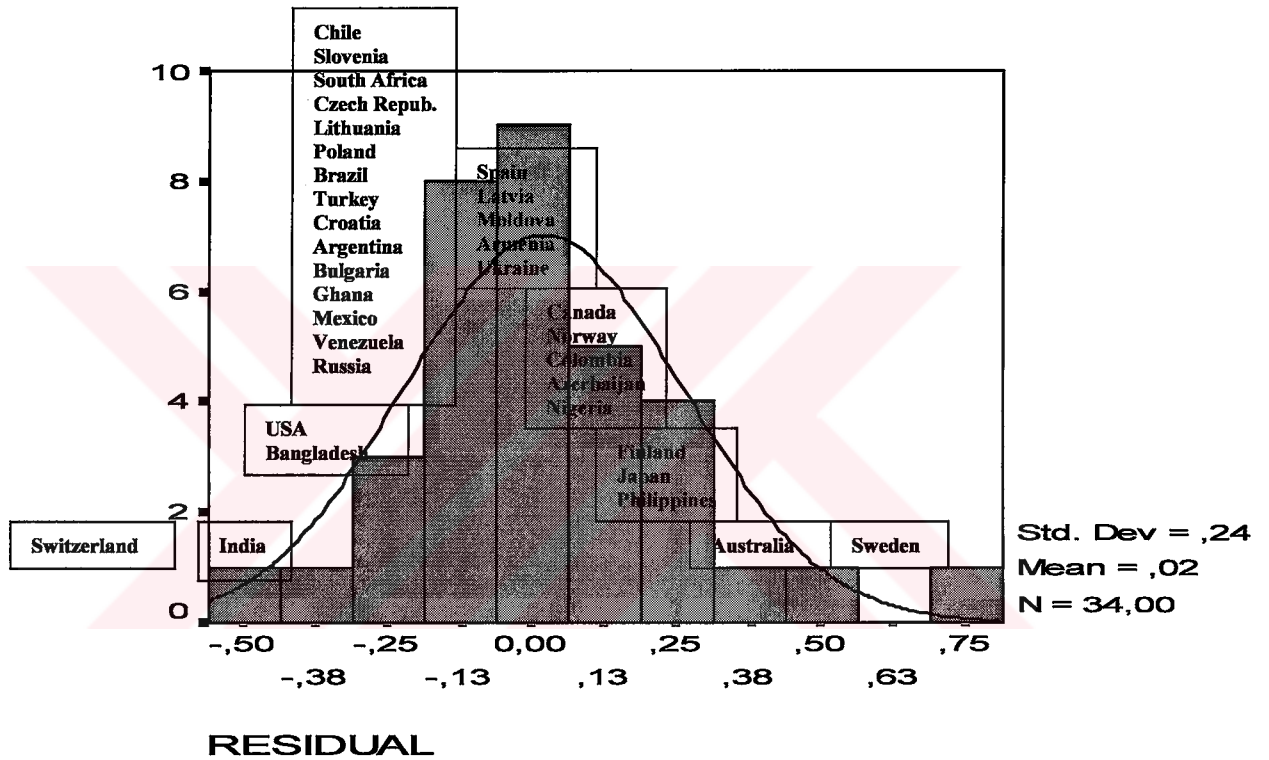
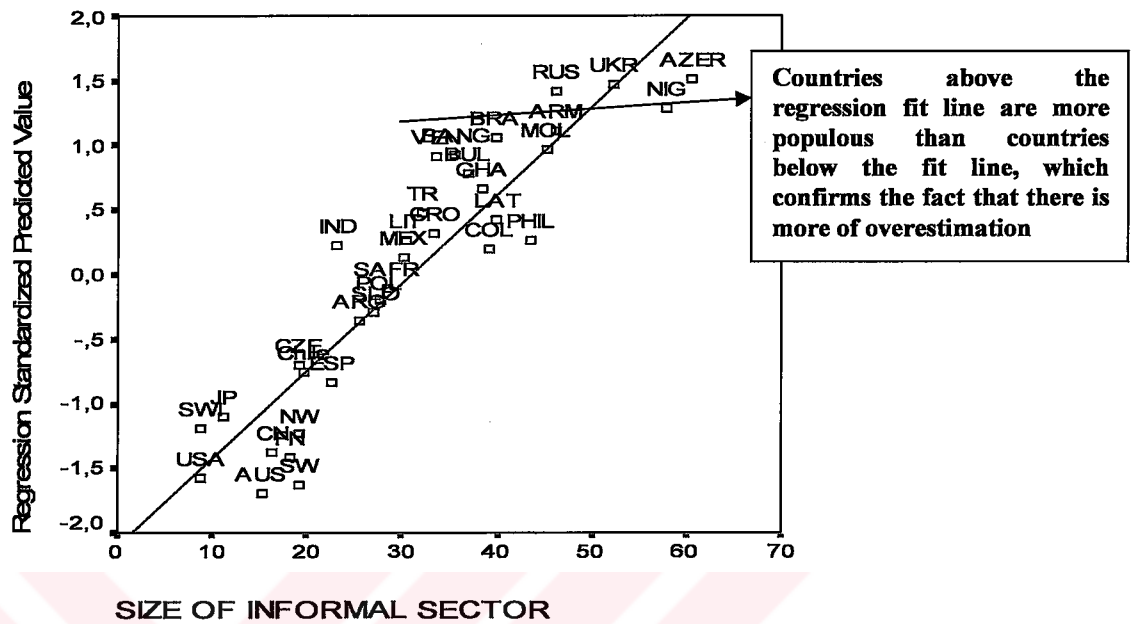


Figure 24. Multiple Regression Line of Informal Sector



The major derivation that can be made from these results is that, the composite variable of CPI score and bureaucratic quality (bureaucratic impartiality) is the single most important determinant of the size of informality. In places where there is a competent bureaucracy with efficiently functioning rules and impersonal service delivery and uncorruptible punishment mechanisms, informal sector is smaller. This finding is even more important when we take the sign of overall fiscal burden into consideration. The finding that as the overall fiscal burden gets bigger, the informal sector gets smaller may seem a little bit contradictory at the first instance. Yet, this finding has also been confirmed in other studies. In a similar study Johnson, Kaufman and Zordo-Lobaton (1998) also found out that countries that have higher income and corporate marginal tax rates and a higher share of tax revenues in GDP have lower unofficial economies. Best tax rates (lowest) are in seemingly unlikely places such as Bolivia and Uruguay which also have big informal sector. This means the perceptions about the tax burden are not a mere function of tax rates but rather a function of the way the tax administration is carried out. The findings of the regression equation are very much supportive of this argument. It is no coincidence that “overall fiscal burden” and “bureaucratic impartiality” are significant at the same time. This indicates that while higher tax rates increase overall tax burden, an efficient public finance

(hence a well functioning bureaucracy) highly compensates this adversity, by the better provision of public goods thanks to higher share of tax revenues in GNP.

One should be careful in defining the tax burden as evaluated by the firms. Here, I used official marginal tax rates as variables. It is interesting to note that higher marginal income tax rates in an honest and non-arbitrary bureaucracy may result in less tax burden on the firm than lower statutory tax rates in a corrupt administration (Johnson, Kaufman and Zordo-Lobaton, 1998:23). The levels of tax rates in themselves do not cause the politicization of the economy which forces firms underground. Much more depends on how taxation and regulation is administered and implemented.

Employment Laws Index, is another variable that turns out to be significant. In places, where practices of hiring, firing and employment conditions are too strict, firms opt for informality.

The more corrupt a society is, the bigger the informal sector, that is for sure. But when we come to the link between confidence in state institutions and informality, the relation is rather unexpected. The relation turns out to be positive, where confidence in state institutions increases, informality also increases. Yet, as the p value is insignificant, it seems there is no direct relation between people's recalcitrant attitude about paying taxes, or playing by the rules of the game with their trust in state institutions. It may very well be the case that they do not even consider their illegal behaviour as malfaisance or breaching citizenship obligations. If one remembers the inclusive aspects of corruption in a society, one understands the prevalence of informality better. In many developing nations, it is quite legitimate to make gift payments to officials, to use official positions to obtain jobs for relatives or to give a private fee to tax collectors for ignoring the informal business. As long as the citizens are able to get their share from this immoral practice, the damaging affects of corruption on the political psychology of citizens is not as big as it might be expected. If corruption in a society is characterized by ease of joining, if it is inclusive, it will have an integrative force and its illegitimacy will not be questioned. Informality in that sense falls into integrative and inclusive form of corruption, due to its inclusive and integrative nature- as it draws buyers and sellers into networks of mutual self-interest- it can become quite

large and pervasive. It could very well be the case that people consider such informal practices as normal and beneficial for the society and they may see no reason in condemning it. That is why; informality has not much to do with trust in state. It is rather a way of life in countries where bureaucracies are corrupt and personal, relationships go along with principles of favor and reciprocity and people perfectly adapt themselves into this web of administrative corruption.



CHAPTER 5: CONCLUSION

This study had its starting point in two competing hypothesis. Is informality due to low levels of trust in state, or is it a side-effect of wide-spread corruption and bureaucratic laxness?

One interpretation is that informality is a reaction to state intrusion in economic affairs due to low levels of solidarity. Large informal economy is a sign that people have little faith in the government's ability to manage the economy and little faith in other citizens beyond their immediate family. When there is disbelief in state capacity to make the economic life better, people do not want intrusion into their economic affairs. A possible attempt to legalize informality is difficult because of this high mistrust between state and society.

Another interpretation is that informality is a way of life for countries where corruption is the norm. As long as people can get their fair share from such practices, nobody will be too harsh about others engaged in similar activities. Especially when the fish rots from the head, that is those institutions that are supposed to guide and regulate the economic activities of the citizens, are themselves prone to corruption, there is no way of blaming the citizenry for being distrustful. They just adapt themselves into this web of administrative corruption.

The findings of my analyses are very much supportive of the second argument. There is no way to claim that low level of confidence in state institutions is specific to mismanaged, corrupt societies with high levels of informality. There may even be an

expectation on the part of informal players that state institutions will be supportive of their illegal practices i.e expecting legal protection to unauthorized shantytowns. The way to fight with informality is not to change the perceptions of people, but to change the way state policies are carried out. With an impersonal, efficient and determined bureaucracy, it will not take long to prove that the state plays according to the rules of the game and expect the citizens to do the same. There may arise some frictions between the state and society on the way of achieving this new equilibrium but there seems to be no better alternative.

This study had many limitations. The years of observation for many of the data sources were different. This was a minor distraction since many of the indexes and variables used in this analysis remain stable for many years and countries more or less show the same performance for a long period of time. Second limitation was the limited number of observations in the final regression line due to the mismatch of countries each index contained. Another difficulty was about the nature of the confidence questions. The macroeconomic indicators were all objective and country-wise. Confidence, on the other hand, is something very much related to personal characteristics as well as unique experiences. I rationalize this case, by referring to those personal experiences with various state institutions as reflecting something meaningful about the way political culture operates at the societal level. For example, there is no other way of trying to figure out the extent of corruption in society than asking people their own experience. People may lie about their own participation, but they will surely reveal many observations and useful insights about informality and corruption.

As a last point, I should admit that a cross country study on informal sector could be more fruitful if the countries at hand could be divided into subcomponents such as developing, developed or transition countries. There should be more consistency in countries with the same levels of development. For instance, most of the OECD countries in our dataset showed approximately the same trend in terms of the relationship between informality and the independent variables. Yet, to decompose the work into subcomponents would be to decrease the number of observations into even smaller numbers which would put the results of this study under suspicion.

APPENDICES

APPENDIX A.

Countries Classified According to Their Income Levels (downloaded from www.nationmaster.com)

High Income	Upper Income	Lower Income	Low income
Finland	Chile	S.Africa	Bosnia
Denmark	Uruguay	Peru	Bangladesh
Sweden	Venezuela	Belarus	Georgia
Canada	Mexico	Turkey	Pakistan
Norway	Latvia	Bulgaria	Nigeria
Holland	Slovakia	Colombia	Azerbaijan
UK	Argentina	Chile	Moldova
Switzerland	Croatia	Romania	India
Australia	Brazil	Philippines	Ghana
USA	Poland	Armenia	
Austria	Lithuania	Russia	
Ireland	Czech Republic	Ukraine	
Spain	Hungary	Dominican Rep.	
France			
Japan			
Portugal			
Belgium			
Slovenia			
Italy			

APPENDIX B. DATASET

Country name	Size of Informal Sector (% of GNP)	Corruption Perceptions Index Score	Bureaucratic Quality Index Score	Fiscal Burden Index Score	Property Rights Index Score	GNP per capita in \$ (PPP)	Confidence in legal system (% of total population)	Confidence in police (% of total population)	Confidence in government (% of total population)	Confidence in civil service (% of total population)	Employment Laws Index 2003 (0=less rigid, 100=very rigid)	Cost to register a business 2003 (% of GNI per capita)
Finland	18,3	10	4	3,5	1	25776	67,2	85,1	34,4	36,9	55	3
Denmark	18,2	9,8	4	4	1	28842	79,4	89,2		51,4	25	0
Sweden	19,1	9,4	4	4	1	25985	63,2	81,3	43,6	49,8	42	1
Canada	16,4	9,2	4	2,8	1	29002	54,4	84,1	37,6	50,1	34	1
Norway	19,1	9,1	4	4	1	32797	69,8	85,6	66,4	51,4	41	4
Holland	13	8,9	4	4,4	1	27107	63,9	73,2		46	54	14
United Kingdom	12,6	8,7	4	3,9	1	25426					28	1
Switzerland	8,8	8,6	4	3,4	1	31891	66,8	69,5	54	49,2	36	9
Australia	15,3	8,3	4	3,8	1	26631	35	75,6	26,4	38,2	36	2
United States	8,8	7,8	4	4	1	35991	36,3	71,2	30,6	51,8	22	1
Austria	10,2	7,7	4	4,3	1	27808	58,5	67,8	41,9		30	7
Chile	19,8	7,4	3	2,6	1	9964	45,9	50	53,3	48	50	12
Ireland	15,8	7,2	4	2,4	1	28974	47,1	85,7	59,4		49	10
Spain	22,6	7	4	4,1	2	21152	49,1	63,1	33	44,7	70	19
France	15,3	6,7	3	4,3	2	25888	57,6	66,5	49,1		50	3
Japan	11,3	6,4	4	4,3	2	28699	79,6	78,7	30,3	36,6	37	11
Portugal	22,6	6,4	3	3,8	2	19322	40,8	44,2		31,4	79	13
Belgium	23,2	6,1	4	4,4	1	29127	44,6	51		42,5	48	11

Slovenia	27,1	5,5	3	3,5	3	19145	35,9	47,4	40,6	28,9	59	16
Taiwan	19,6	5,5	3	3,3	2	17962	55,7	57,7	69,7	53,2		
Uruguay	51,1	5,5	2	3,5	2	7857	59,7	53,2	41,6	44,8	39	47
Hungary	25,1	5,2	4	3	2	13339	59,6	50,5	49,6		54	64
South Africa	28,4	5	2	3,9	3	10000	66,8	75,1	71,6	63,9	36	9
Italy	27	4,6	2,5	4,1	2	25086	31,7	64,9	25,1		59	24
Peru	59,9	4,4	2	3,3	4	4885	20,3	26,4	42,5	17,7	73	25
Czech Republic	19,1	4,3	3	3,9	2	15328	45,6	34,2	48,4	33,6	36	12
Belarus	48,1	4,1		3,4	4	8737	51,2	39,3	54,3	56,6	77	27
Lithuania	30,3	4,1	2,5	2,4	3	8372	29,1	24,8	41,7	49,3	64	6
Poland	27,6	4,1	3	3,6	3	9662	56,5	54,9	43,3	42,3	55	20
Brazil	39,8	3,9	2	2,5	3	7559	55,1	45,7	49,1	59,5	78	12
Turkey	32,1	3,8	2	3,9	3	7189	68,6	68,8	47,5	67,5	55	37
Croatia	33,4	3,7	3	3,1	4	9750	58,4	66,3	59,5	42,7	65	18
Argentina	25,4	3,5	3	3,8	4	10423	26,6	22,6	26,7	7,9	66	8
Bulgaria	36,9	3,5	2	1,8	4	6530	43,4	54,1	62,5	54,6	53	8
Ghana	38,4	3,5	2	4	3	2015	85,9	76,5	93,7	96,8	35	112
Slovakia	18,9	3,5	3	2,9	3	12401	27,2	35	30,1		61	10
Latvia	39,9	3,4	2,5	2,6	3	8936	40,3	32,7	39,8	46,6	62	15
Mexico	30,1	3,3	3	4	3	8811	41,7	33,7	42,3	42,2	77	19
Dominican Rep.	32,1	3,3		3,1	4	6170	14,4	12	12	9,1	49	48
Bosnia	34,1	3,3		2,5	5	1830	69,4	78,7	69,3	54,9	49	52
Colombia	39,1	3,2	2	4,3	4	6039	49,1	50,4	38,1	33,9	59	27
China	13,1	3,1	2	4,4	4	4653					47	14
Romania	34,4	2,9	1	3,1	4	7601	47,6	45,1		30,5	54	12
India	23,1	2,8	3	3,6	3	2537	82	51,7	67,4	77,3	51	50

Philippines	43,4	2,8	3	3,5	4	4487	66,9	55,9	59,6	68	60	24
Venezuela	33,6	2,7	1	4,3	4	5341	37,4	30,1	26,6	31,2	75	19
Moldova	45,1	2,6	2	2,4	3	2592	50,6	34,2	45,2	58,1	67	26
Armenia	46,3	2,5	1	2,3	3	3646	33,4	33	43,9	39,7	57	9
Pakistan	36,8	2,5	2	4	4	1959	50,1	16,4		47,2	58	47
Russia	46,1	2,1	1	2,6	4	9749	41,1	31,5	28,5	53,2	61	9
Georgia	67,3	1,8		2,4	4	3252	41,7	34,4	46,3	48,3	55	26
Azerbaijan	60,6	1,5	1	3,4	4	3653	49,4	46	92,8	51,4	63	17
Ukraine	52,2	1,5	1	3,9	4	4536	47,4	41,1	47,8	51,3	73	27
Bangladesh	35,6	1,3	2	4	4	1720	71,9	36,1	77,2	71,5	50	76
Nigeria	57,9	1,2	1	3,5	4	840	55,8	47,6	41	63,3	43	92

APPENDIX C. COUNTRY ABBREVIATIONS

Country name	Abbreviation	Country name	Abbreviation	Country name	Abbreviation
Finland	FN	Taiwan	TAI	Mexico	MEX
Denmark	DN	Uruguay	URU	Dominican Rep.	DOM
Sweden	SW	Hungary	HUN	Bosnia	BOSNI
Canada	CN	South Africa	SAFR	Colombia	COL
Norway	NW	Italy	IT	China	CHI
Holland	HL	Peru	PER	Romania	ROM
United Kingdom	UK	Czech Republic	CZE	India	IND
Switzerland	SWI	Belarus	BEL	Philippines	PHIL
Australia	AUS	Lithuania	LIT	Venezuela	VEN
United States	USA	Poland	POL	Moldova	MOL
Austria	Austria	Brazil	BRA	Armenia	ARM
Chile	CH	Turkey	TR	Pakistan	PAK
Ireland	IR	Croatia	CRO	Russia	RUS
Spain	ESP	Argentina	ARG	Georgia	GEO
France	FR	Bulgaria	BUL	Azerbaijan	AZER
Japan	JP	Ghana	GHA	Ukraine	UKR
Portugal	PR	Slovakia	SLOVAK	Bangladesh	BANG
Belgium	BEL	Latvia	LAT	Nigeria	NIG
Slovenia	SLO				

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