**Will Deregulation and Strengthening Formal/State institutions solve the Problem of Post-Socialist Informality?**

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**Abstract:**  
After 20 years of post-socialist transformation informality is still on rise. Informality, initially seen as a transitional phenomenon, did not wade away as a result of marketization process. Since the end of 1990s the new-institutionalists suggested that simplifying overregulated economies of Post-Soviet states, and improving quality of government are the key solutions to reduce importance of informality in the region. In this paper I examine the validity of new-institutionalist solution with help of Polanyi’s theory on market society and I ground the analysis in existing ethnographic case studies of informality. Informal economy not only seems deeply embedded in social and cultural context of respective societies, but it transforms and adjusts primarily in response to the marketization process, thus can be seen as an attempt of re-embedding the economy into society. I argue that new-institutionalist solution is at best insufficient and at worst misleading in explaining informality in post-Soviet states.

**Contents**  
Introduction..........................................................................................................................................................2  
I. Three perspectives on Informal economy ........................................................................................................3  
II. Research on informality in Post-Socialist states ...............................................................................................6  
   II.I Why would informals welcome deregulated market economy? De Soto’s Solution to informality...8  
   II.II De Soto’s assumptions versus Polanyi’s theory on capitalist society.........................................................9  
   II.III Can post-socialist informality be seen as ‘informal capitalism’?..............................................................11  
III. Theoretical framework for studying the transformation of informal economic practices ............14  
Conclusions..........................................................................................................................................................16  
Bibliography ......................................................................................................................................................18
Introduction

Informality in post-socialist countries is hard to study as it cannot be readily explained by existing theoretical approaches, and because it has been transforming in response to diverse socio-economic changes in the region throughout last two decades. As, Morris and Polese, the editors of last volume on post-socialist informal economy summarize: “There is perhaps only one certainty about informality in the region that we can glean from reviewing the attempts to quantify it: it has increased markedly since the end of the socialist period, and certainly since 2000, and it is at the very least a fifth of GDP in the westernmost states (Slovakia in our example), and perhaps 40 per cent or more in Russia, Ukraine, the Caucasus and Central Asia” (Morris & Polese, The Informal Post-Socialist Economy: Embedded Practices and livelihoods, 2013).

In post-socialist countries and most particularly in post-soviet countries, just like in much of the developing world, informal economic practices and informal institutions have played a controversial role. On one hand, informality or ‘exit’ type solutions, have served as a mechanism for ‘getting things done’ (Ledeneva A., From Russia with Blat: Can Informal Networks Help Modernize Russia? , 2009) in unstable societies; often providing economically vulnerable segments of population with alternative solutions to cope with socio-economic hardships (Ledeneva A., 2009; Round & Williams, 2010; Burawoy & Verdery, 1999; Barsukova & Radaev, 2012 ). One the other hand, informal practices were seen as a big part of the problem, as a suboptimal solution, root of exclusion and as a subversion of state enforcement capacity. It was argued that informal practices might lead to the ‘closure of the labour market’ (Clarke, 1999) or produce ‘an anti-modern society’ that hampers the normal functioning of market economy and eventually impedes growth (Rose, 1998; Paldam & Svendsen, 2000). The ethnographers who emphasize the importance of social networks and informal practices for daily survival of poor and vulnerable in former soviet republics, voice concerns that the coping tactics that have helped the marginalised in the past are not sustainable: “As the last 20 years have shown, people will ‘cope’ with economic marginalization, but, as populations age and big expenses such as major household repairs become ever more pressing for many, it is a dangerous assumption that this will continue into the future” (Round & Williams, 2010, p. 193).
According to new-institutionalist analyses, one of the main factors that hamper development of Post-Socialist states is the penetration of social, political and economic spheres by informality and corruption. In turn, the prevalence of informality and corruption are consequences of weak enforcement capacity, overregulation and overall low quality of institutions (Rose, 1998; Paldam & Svendsen, 2000; Clarke, 1999). Hence, the solution offered by academics and development practitioners alike, is to strengthen state/formal institutions and also to deregulate and liberalize economy. In relation to informal economic practices, new-institutionalist approach is best articulated in the writings of Peruvian economist Hernando De Soto. Soto suggests that improved institutional framework coupled with elimination of extensive bureaucracy and red tape should lower the costs of formalising economic activity for the informal entrepreneurs (De Soto, 1989).

Relying on Polanyi’s theory on different modes of social-economic integration and market society, this article aims to critically evaluate new-institutionalist predictions on institutions and informal economy in Post-Socialist context. In contrast to new-institutionalist assertions over rationality of economic actors that voluntarily escape costly regulations and bureaucratic red tape, the ethnographic research on post-socialist informal economy has been underlining social and cultural embeddedness of informal economic practices (Morris & Polese, The Informal Post-Socialist Economy: Embedded Practices and Livelihoods, 2013). The current article argues that emerging emphasis on embeddedness of informal economic practices makes Polanyian institutionalism relevant while re-examining validity of new-institutionalist claims on informal economic practices and can guide the research towards elaborating alternative theoretical framework to study informal economic practices in the region.

I. Three perspectives on Informal economy

Study of informal economy counts only several decades. Although it was believed to be a temporary phenomenon that would disappear together with modernization, informal economy proved to be prevalent and growing part of economic activities not only in developing but also in advanced economies. Informal economy has been depicted in numerous ways: as shadow economy (Schneider & Enste, Shadow Economies: Size, Causes, and Consequences, 2000); as unofficial economy (Hibbs & Piculescu, 2005) (Jonson, Kaufmann, & Zoido- Lobaton, 1998); or as hidden economy (Frey & Weck-Hanneman, 2005). All of these terms depict the economic
activity that takes place outside of state regulation. One of the broad, and widely used definition of informal economy states that informal/shadow economy comprises of: “those economic activities and the income derived from them that circumvent or otherwise avoid government regulation, taxation or observation” (Schneider, 2006).

The birth of the concept is connected with the research of Keith Hart, economic anthropologist whose study in Kenya underlined the importance of informal sector for the survival of the poor. The emergence of informal sector was seen as a result of lack of access to and availability of formal jobs. The term ‘informal sector’ was later replaced by ‘informal economy’ as the researchers realized that informal activities were not confined to any single sector but were interconnected with formal economy. In 1990’s the old definition by ILO that included only employees of informal enterprises was challenged by the definition that includes “all non-standard wage workers who work without minimum wage, assured work, or benefits, whether they work for formal or informal firms” (Chen & Carr, 2001, p. 5).

The formal/informal divide and the spread of informal economy are commonly analyzed through three competing perspectives. The dualist perspective portrays informal economy as a separate, marginal economy which is not directly linked to formal (capitalist) economy and which is expected to disappear as economies modernise and develop. In contrast, the structuralist perspective emphasizes interrelatedness of formal and informal economies. The structuralist argue that spread of informal employment is a result of the structural changes in capitalist mode of production, which force entrepreneurs to downsize, outsource, subcontract and ‘go informal’ in search of increased flexibility and lower production costs (Castells & Portes, 1989). The dualist perspective has been challenged theoretically and empirically for inability to theorize interconnectedness and interdependence of formal and informal economy, and incapacity to explain persistence and increase in informal employment worldwide (Dibben & Williams, 2012; Jütting & Laiglesia, 2009). The structuralists, in turn are criticized for inability to account for subsistence and self-employment activities (Routh, 2011).

The third, legalist/new-institutionalist perspective on informal economy was sometimes regarded as one of ‘structuralist’ frameworks, as this perspective also finds structural conditions, such as cumbersome laws, burdening regulation and bureaucratic incapacity as main reasons pushing individual entrepreneurs to operate informally. However, there are principal differences
between the structuralist and the new-institutionalist approaches which make the two competing, rather than complementing perspectives. While the structuralists support greater state intervention in work and welfare provision, new-institutionalists find extensive state intervention and lack of state bureaucratic capacity as main challenges for informal entrepreneurs.

The academic consensus on development, that started emerging since 1990s, acknowledges institutions as key variables to explain developmental outcomes. The new institutionalists emphasize ‘primacy of institutions’ to explain better economic growth and improvements in quality of life (Sokoloff & Engerman, 2000; Robinson, Acemoglu, & James, 2000; Rodrik, 2004; Kohli, 2004; Tabellini, 2004). Economic development is seen to be conditioned on predictability of rules and state’s capacity to secure private property. More often the dependent variable in the institutionalist research is economic growth, which does not in itself tell us about distributional effects of institutions. But as growth proves to be insufficient measure of development, the institutionalist research has moved to explore the impact of institutions on other developmental outcomes like poverty, inequality and growth. For example, Henderson et al., provide statistical evidence to claim that ‘bureaucratic quality of public institutions is decisive for that country’s ability to reduce poverty’ (Henderson, Hulme, Jalilian, & Phillips, 2003).

As the research on the importance of institutions for various developmental outcomes has gained prominence, the new-institutionalist explanation of informality has also been increasingly supported by the rich evidence. Recently, Signh et. Al have asserted primacy of institutional variables versus other explanations for explaining the size of informal/underground economy: “It is important to note that institutions are the most important determinant of the size of the underground economy. Once we control for institutions, taxes, inflation, and per capita income are no longer statistically significant. Therefore it is not higher taxes per se that leads to increased shadow economy but rather weak institutions and rule of law” (Singh, Jain-Chandra, & Mohommad, 2012).

Unlike the Study by Signh et. Al., in his recent analysis on the determinants of the extent and nature of informal employment, Colin C. Williams includes the extent of state intervention in worker’s protection and welfare provision. Testing systemically the validity of the three competing explanations on spread and nature of informal employment on the example of
European Union member states, the statistical analysis offered by Williams partially supports new-institutionalist claims indicating that ‘quality governance’ and low rates of corruption adversely affect spread of informal employment. However, in contrast to new institutionalist assertions, and in line with structuralist thesis, Williams demonstrates that the extent of state intervention in labour markets and welfare provisioning are one of the strongest determinants of the spread and nature of informal employment: “greater state intervention in labour markets and welfare provision is strongly correlated with lower levels of informal employment and with workers engaging in informal employment out of choice rather than because of exclusion” (Williams, 2013).

While statistical analyses advance competing claims, this article intends to examine micro-level foundation of the new-institutionalist perspective. The starting point of broadly conceived new-institutionalist theory is human behaviour. It argues for the importance of social norms and formal rules in shaping individual perceptions, expectations and choices which in turn affect costliness of transaction, and actor’s access to information (North, 1990). Thus, in order to qualify new-institutionalist claims on the importance of good state bureaucratic capacity coupled with simple regulatory framework, we need to ask why would this solution enable and moreover, motivate informally employed persons to formalise their economic activity.

II. Research on informality in Post-Socialist states

In the context of post-socialism neither dualist nor structuralist approaches have influenced the debate on informality as much as legalist/new-institutionalist approach did. While dualist, or modernisation perspective was criticised for inability to comprehend continued importance of informality in the region (Morris & Polese, 2013) and structuralism was criticised for inability to explain small scale informal exchange, self-help and self employment (Routh, 2011), post-socialist informality has been most frequently explained through new-institutionalist arguments, pointing out overburdened and overlapping regulations, unstable and fuzzy legal systems, flaws in state enforcement capacity and overall weakness of state institutions (Ledeneva A., 2006; Humphrey, 2002).

When it comes to understanding both, the failure of socialist system and the challenges of post-socialism, neo-institutionalist approach dominates not only works of political scientist, economists and sociologists, but also ethnographers and anthropologists (Thelen, 2011).
Moreover, the propositions of new-institutionalist theory have shaped the developmental agenda on national and transnational level, resulting in endless but often futile efforts to reduce corruption and strengthen rule of law, transparency and accountability in post-Soviet states. But recently, Thelen has argued that focusing on deficiency of institutions in post-socialist and more particularly in post-soviet countries has created ‘dead ends’ in research agenda. Focus on the inability of former soviet states to put in place market supporting institutions, and protect private property has lead to subsequent ‘othering’ of these states.

Even the most critical ethnographers of post-socialist informality, like Alena Ledeneva or Abel Polese, have cited one of the exemplary works from legalist/new-insitutionalist tradition by Hernando De Soto (De Soto, 1989), arguing that unreasonable taxes and complicated regulations make it hard for informally operating actors to formalise their economic activities. Solutions offered by De Soto, have been primarily appraised for challenging commonsence negative prejudices on informals and informal economy, and for suggesting that the institutional frameworks of respective states should respect and incorporate extralegal norms and rules developed in informal sphere.

In the following sections, the arguments by De Soto will be discussed as representative texts of new-institutionalist perspective on institutions and informality. Out of broad literature on the importance of institutions (Sokoloff & Engerman, 2000; Robinson, Acemoglu, & James, 2000; Rodrik, 2004; Kohli, 2004; Tabellini, 2004 ; North, 1990; Rothstein & Teorell, 2008 ) De Soto’s work is selected for two interrelated reasons. Firstly, De Soto primarily focuses on the importance of institutions for reducing the size and spread of informal economy and for solving the problems of poverty and marginalisation. Secondly, unlike many researchers asserting the decisive role of institutions on informality using aggregated data to make cross-country comparisons (Schneider, Buehn, & Montenegro, 2010; Schneider, 2006; Hibbs & Piculescu, 2005; Jonson, Kaufmann, & Zoido-Lobaton, 1998), De Soto theorises specific, micro-level mechanisms, through which state level institutional changes should be translated in altered motivations, constraints and opportunities of the numerous poor of developing countries.
II.1 Why would informals welcome deregulated market economy? De Soto’s Solution to informality

De Soto’s widely sighted book “The Other Path” gives an in depth description of how the poor of the developing world organize outside of formal economy, create parallel informal world and manage their settlements as well as economic life, trade, markets and infrastructure (De Soto, 1989). For De Soto, even if informality serves well for the survival purposes, this same informality is the main reason why the poor remain poor. According to De Soto’s theory on the mystery of capital, a large portion of resources held by informals cannot be used productively because of missing information and insecurity of formal property system, which results in inability of capital accumulation in the developing world (De Soto, 2000). In his view, the poor are not hopeless victims, but they already possess resources, property as well as entrepreneurial skills, however, “these resources are held in defective forms: there is no information, no formal property rights, no adequate documentation, no formal representation, and thus, these assets cannot be turned into capital, they cannot be traded outside informal, narrow circles and they cannot be used to propel further capital production” (Olaya, Díaz, & Caicedo, 2007).

While informal solutions are costly and problematic, high costs of access to formal industry, housing, trade, transportation explain why so many people opt out to operate informally. As the main obstacle is seen in deficient institutions, logical solution is “to change our legal institutions in order to lower the cost of producing and obtaining wealth and to give people access to the system so they can join in economic and social activity and compete on an equal footing” (De Soto, 1989, p. 244). To give informals opportunity of using their skills and assets for productive means, De Soto offers: simplification – reducing bureaucracy and eliminating costly legal institutions; decentralization – transferring responsibilities to local governments; deregulation – transferring some of state responsibilities to private bodies. Moreover, De Soto argues that when designing new ‘good’ institutions, the policy makers should take into account existing informal practices that are developed and respected by informals: “we should draw on what actually works. More specifically, we must draw on the extralegal system which, as we have seen, most of the population accepts” (De Soto, 1989, p. 245).
II.II De Soto’s assumptions versus Polanyi’s theory on capitalist society

If the solutions of De Soto are to result in the expected outcomes, four explicitly and sometimes implicitly underlying assumptions of his theory should stand:

- Firstly, in case the costs of formality are affordable for the informally operating actors, they will choose to formalize their activity and moreover, they will all benefit from it.
- Secondly, it is possible and desirable to incorporate informal extralegal norms into formal institutions that provide the framework for deregulated market economy.
- Thirdly, if it is possible to incorporate informal extralegal norms, then informal economy can be seen as essentially already capitalist. The only difference between formal capitalism and its mirror, ‘informal capitalism’ is that the latter is inferior because it provides less security to the actors. Thus difference between informal and formal capitalism is related to a degree of security and quantifiable costs of transactions.
- Lastly, the motivation as well as rational judgment of the actors engaged in informal economy should resemble the motivation and rationality of persons operating in market economy.

Because all of these assumptions are related to understanding virtues and problems of capitalism, my suggestion is to contextualize them with the help of Polanyi’s theory on capitalist society. Relying on Polanyi’s definition of capitalist society is relevant not only because this theory has informed some of the most significant works on challenges of modern capitalism (Streeck, 2010; Streeck, 2009) and influential studies on the capitalist diversity in Central and Eastern Europe (Bohle & Greskovits, 2012), but also because the scholars of post-socialist informal economy increasingly insist that the informal economy is embedded in social and cultural context of post-socialist societies (Morris & Polese, 2013). The emphasis on embeddedness of informal economy, on the importance reciprocity and mutual favors, kinship and ethnic ties, makes Polanyi’s work primarily relevant for understanding the characteristics of informal economic practices in post-socialist states.

De Soto’s first assumption, that engagement in deregulated market economy, where private property is safeguarded, can be a solution out of poverty and informality would be certainly rejected by Polanyi. While De Soto, like many other new-institutionalists sees ‘a harmonious, win-win dynamic in capitalism’ (Obeng-Odoom, 2013, p. 431), for Polanyi the self-regulated market economy inevitably produces poverty and numerous losers. Without taking protective measures, the market institution can lead to the destruction of mankind and nature (Polanyi, 1957 [1944]). When Polanyi talks of the social costs of marketization, his concern is
not simply directed toward worsened income, but more importantly towards the disintegration of the institutions, in which man’s social life was traditionally embedded. He argues that if the ‘countermovement’ or the protective measures did not alleviate the costs of marketization, “human beings would perish from the effects of social exposure… Finally, the market administration of purchasing power would periodically liquidate business enterprise, for shortages and surfeits of money would prove as disastrous to business as floods and droughts in primitive society” (Polanyi, 1957 [1944], p. 76). This vulnerability of human and natural conditions is caused by disposing land, labor and money on commodity market. The competition, which often leads to monopoly, is another reason why, according to Polanyi, many economic actors can be laid aside under self-regulated market economy. Thus, having unimpeded access to self-regulated markets, from this standpoint, will not solve the problem of poverty; instead those that are left vulnerable as a result of marketization should be compensated with the intentional regulation of markets.

According to the second assumption of De Soto it is possible to incorporate informal norms and practices into the legal framework that safeguards market economy. Evaluation of this proposition requires recalling the definition of market economy, which according to Polanyi is: “an economic system controlled, regulated, and directed by market prices; order in the production and distribution of goods in entrusted to this self-regulating mechanism”. For this self-regulated system to work, it is necessary that land, labor and money are on sale and priced according to market prices. The institutions and extralegal norms that informals device in different parts of the world can be incorporated in this system only as long as they do not distort, or do not intervene with self-regulated price mechanism. Therefore, before one talks of the possibility of incorporating informal extralegal norms into market economy, one needs to empirically establish two conditions: that these norms do not hinder the self-regulating system of price making, and that the motivation of the actors is similar to the motivation assumed in capitalist system. In Polanyi’s words, we should empirically confirm existence of economic man and economic society.

For De Soto, as well as the rest of new-institutionalists, the existence of both, economic man and economic society, is assumed – it is timeless and universal. This is why, they maintain, that the ultimate success of economy depends on securing one core institution required for functioning of market economy, namely private property; similarly, they assume that once the
security of private property is guaranteed by the state, the economic actors will willingly choose to be part of formal market institutions.

In contrast, Polanyi contends, that “in no case can we assume the functioning of market laws unless a self-regulating market is shown to exist” (Polanyi, 1957 [1944], p. 44). For Polanyi, economic liberals misread the history, because they assumed existence of economic society, forgetting that this type of society is a novelty in the history of mankind. He extensively discusses the ethnographic evidence to map out integrative transactional modes substantially different from market mechanism. Prior to institutionalizing markets, the societies were integrated based on three mechanisms - reciprocity, redistribution and household - that were present (separately or in combination) throughout all pre-capitalist history. While in pre-capitalist societies the economy was subordinated to, and embedded in, social and political organization of the respective societies\(^1\), market economy is the only institutionalized mechanism which allows subordination of the society to the needs and logic of economy.

II.III Can post-socialist informality be seen as ‘informal capitalism’?

In order to qualify De Soto’s last two assumptions - existence of economic man and economic society – we need to look at the evidence on informal practices and institutions in post-socialist societies, collected and analyzed mostly by anthropologists and human geographers.

When talking of informality in post-socialist states, we need to consider definitions of different forms of informality – as economic practice, as norms and institutions, as networks. Informal economy has been numerously defined, but most of the definitions hold that this is the part/side of the economy that escapes state supervision and regulation, while informal employment is often associated with precarious working conditions (Routh, 2011). Informal institutions are defined as “socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels” (Helmke & Levitsky, 2004, p. 727). Informal practices are seen as instances when informal norms are enforced; they are “people’s regular strategies to manipulate (or exploit) formal rules by enforcing informal norms and personal obligations in formal contexts. Such strategies involve the bending of both formal rules and informal norms, or navigating between these constraints by following some and

\(^1\) It needs to be underlined that Polanyi does not perceive pre-capitalist societies as systems that were necessarily more just or provided more freedom. Reciprocity and redistribution are found in tyrannies as well as egalitarian communities.
breaking others” (Ledeneva A. V., How Russia really works: the informal practices that shaped post-Soviet politics and business, 2006). Another widely used term is informal networks that denotes circle of people, socially involved with each other (Granovetter, 1983). Recalling diverse ‘faces’ of informality is important to underline that even if informal economy is outside state/formal regulation, it is not necessarily unregulated, or dominated by market institution. Most of the research of Post-soviet informality indicates that it is rather firmly embedded in social and cultural context of respective societies.

Diverse academic literature that examines the role of informality in daily lives of the citizens of post-socialist states and the reasons for relying on informality, consistently underlines that the motivation of the groups of individuals practicing informality cannot be reduced to economic reasons, neither to survival purposes. The editors of latest volume on ‘The Informal Post-Socialist Economy’, Morris and Polese, insist that the evidence from various case studies, ranging from Slovakia to Azerbaijan, suggests: “Even for the most marginal citizens studied in this volume… informality is tactical, in the Certeau-esque sense – embedded in social life rather than part of a rationalist economic reasoning; informality is often about ‘poaching’ opportunities and utilizing the rules, and the gaps therein, of the formal” (Morris & Polese, The Informal Post-Socialist Economy: Embedded Practices and Livelihoods, 2013, p. 8). While in some cases informal economy is clearly organized alongside the kinship and ethnic lines (Karjanen, 2013), the reciprocal relations and favors also extend to less stable and definite communities and identities. One of the most prominent ethnographers of socialist and post-socialist informality, Alena Ledeneva identifies different regimes in which blat – “exchange characterized by a reciprocal dependence, which endangers regard for and trust in the other over the long term” – can operate (Ledeneva A. V., 1998). Three regimes of reciprocity, regime of equivalence, affection and status, operate in diverse contexts, ranging from close friendship and kinship circles to asymmetrical, patron-client type relations. These exchanges form “economy of favors’, a set of normative obligations to provide assistance to others” (Ledeneva A. V., 1998), where relationships are the main assets gained through mutual help, and possible utility of these relationships are not quantified.

Can those informal economic practices that are motivated by reciprocity and embedded in social organization of respective societies be perceived as comprising ‘informal capitalism’? When describing the diversity of capitalisms on Europe’s periphery, Bohle and Greskovits, are
one of the rare authors explicitly asserting that some of the post-communist states cannot be mapped out into types of capitalisms, but are seen rather as non-regimes (Bohle & Greskovits, 2012). From a different theoretical perspective, the human geographers, working in the paradigm of ‘diverse economies’ see big part of informal practices as non-capitalist (Stenning, Smith, Rochovská, & Świątek, 2010; Gibson-Graham, 2006). Directly relying on Polanyan classification of integrative transactional modes, some scholars suggest that in many post-communist societies reciprocity and redistribution still coexist together with market pattern: “The free market exchange was officially institutionalized as the economic integration pattern, whereas basic informal institutions like vruzki assert reciprocity and hidden redistribution as integrative modes (Pasynkova, 2013, p. 193).”

These assertions do not mean that the process of marketization is not taking place in post-Soviet states, but that “non-capitalist economic relations are constitutive of the extension of the market in a reciprocal set of relationships involving the construction of value, action and a diverse range of economic practices” (Smith & Rochovská, 2007). Neither can we say that all informal practices or whole informal economy is ‘non-capitalistic’ or dominated by not-for profit motives, rather, the peculiar, but significant segment of post-communist societies relies on the practices that contradict the logic of self-regulating and formalized market economy to make their livelihood, to build “social cohesion and sustain wider community life” (Smith & Rochovská, 2007).

To summarize, existing research on informal practices in post-Soviet and more broadly in post-socialist states indicates that: the motivations of persons engaged in informal economy cannot be reduced to profit seeking or survival; informal economy cannot be seen as ‘mirror capitalism’. Not only much of the existing informal economic practices can be seen as incompatible to the logic of self-regulating market, but they are even articulated in opposition to the market, or in defense against national neoliberal projects of modernization (Smith & Rochovská, 2007). In the light of this evidence, it is very hard to imagine that the choices and perceptions of the actors engaged in informal economy can easily be altered through decreasing costs of formality, or inserting ‘good laws’ as De Soto offers. Calculation of ‘costs and benefits’ are shaped in the conditions where actors need to factor in social responsibilities, kinship obligations, perceptions on morality, etc. To say otherwise, we cannot expect that deregulated
III. Theoretical framework for studying the transformation of informal economic practices

For understanding the role of institutions for shaping informal economic practices, I suggest the Polanyi’s theoretical arguments can be helpful on two different levels. Firstly, his arguments can be helpful to distinguish among different (even if coexisting) modes of integration, and secondly for understanding the role of informal economic practices in the process of marketization, and also in the process of resistance, or countermovement against marketization.

From Polnayian perspective capitalist society experiences two movements toward opposing directions. The movement towards marketization, attempts to free, or disembed the economy from non-economic institutions and subject it to self-regulating price mechanism. In response, society inevitably resists and attempts to slow down the pace of market entrancement, in order to protect itself. These processes, described by Polanyi as ‘double movement’ is at the heart of explaining inherent instability of capitalism. The main difficulty is that countermovement can, and often does hamper the functioning of self-regulated markets, and imposes yet another type of costs on the whole society. Hence the stability of capitalist system depends on delicate balance between market efficiency and protection of the society. As Bohle and Greskovits explain, the state come in as an important actor to pursue marketization proces on one hand and to protect society from the harms of the process on the other hand, through carefully constraining market and providing social welfare: “It is, then, ultimately in the capacities of the political sphere that the secret of capitalist success lies” (Bohle & Greskovits, 2012, p. 16).

The state can help movement towards marketization through “a) the establishment of the preconditions for a market economy to come into existence (enclosures, the establishment of a “free” labor market, etc.) (Machado, 2011, p. 123). However, to ease social resistance and compensate for the social costs of marketization the state also can put forth market constraining regulations, “protective measures against disembeddedness, primarily to slow down the pace of
change brought about by the transformation into a market economy (labor laws, Speenhamland, etc.)” (Machado, 2011, p. 123) and provide social welfare.

The role of community scale informal economic practices in the societies that aspire for establishing functional market economies can be twofold. Firstly, to a certain extent, informal economic practices might be integrated along other modes than market. In post-communist societies the role of reciprocal exchange, household production, and even existence of redistributive mechanisms has been detected (Pasynkova, 2013). As Smith and Rochovska propose, informal practices can be essentially non-capitalist (Smith & Rochovská, 2007). Thus, informal practices can be embedded in existing social structures, kinships, networks and informal norms. Secondly, in the process of marketization, informal economic practices can also be articulated as a resistance, or movement towards protecting existing social institutions against market forces.

If and when informal practices take on the two roles mentioned above, as new-institutionalists also suggest, they have a capacity to distort market efficiency, get in the way of self-regulating market. However, new-institutionalists only assert that one part of regulations should be in place, namely the regulations that support efficient functioning of the markets. The other side of the regulations, or institutionalization of countermovement for social protection, is rendered unimportant, or at best, seen as a byproduct of marketization process. However, for Polanyi, emergence of countermovement in one or another form is inevitable. Experience of post-Soviet region only indicates that when social protection is not institutionalized successfully, it continues functioning in informal realm. In this light, continuous increase in the size of informal economy throughout post-soviet countries in response to advancement of neoliberalism only seems logical. In conclusion, then, it is not deregulation, but very careful regulation that can potentially decrease the importance of informality. Whether, respective polities have the capacity of providing both types of regulations, the ones supporting market functioning, and the ones protecting society, is another matter, but unless they master both, we cannot expect withdrawal of the importance of informal practices for social reproduction in Post-Soviet states.

Looking at informal practices from the perspective of their role in double movement, can be helpful to overcome continuous focus on the ‘deficiencies’, ‘wrong legacies’ and consequent ‘othering’ of post-soviet societies. However, I do not think there is a simple way of mapping
informal practices and informal institutions along Polanyian modes of integration, or, that it is justified to qualify any kind of informality as ‘countermovement’. Instead, specific cases, situated in specific contexts, can be analyzed with help of Polanyi’s concepts.

**Conclusions**

This article has outlined shortcomings of new-institutionalist approach to informality arguing that Polanyian institutionalism can provide a better framework for understanding spread and persistence of informality in post-socialist states. Small scale informal trade or other economic practices might not grow into flourishing entrepreneurship spontaneously as a consequence of liberalisation even if supported by strong formal/state enforcement capacity (Humphrey, 2002). The reasons why De Soto and other institutionalists cannot account for persistence and even growing importance of informal practices and norms, and why the case of petty trade in Georgia cannot be explained through observing costs of formality and informality, can be summarised in two points. Firstly, as new-institutionalists assume existence of economic man and economic society, they fail to recognise that informal practices can represent modes of integration qualitatively different from and incompatible with market economy. Existing evidence on informal practices and norms in post-socialist countries illustrates that reciprocity and redistribution still coexist with formally institutionalised market mechanism (Pasynkova, 2013). Consequently, three fictitious commodities – land, labour and money – are not commodified or being sold according to market prices but rather accessed through the informal networks and their use is influenced by informal norms and social organisation of a respective society. The dependence on collective reciprocity or redistribution makes individual material interests relatively unimportant compared to the interest of meeting social expectations of contributing to family or community welfare., informal cannot be simply *remade* into formal capitalism through lowering the entry costs, as it should firstly be *unmade* to enable markets define the prices.

Secondly, new-institutionalists majorly focus on the institutions that support functioning of free markets and deny the costs that market economy imposes on society. In contrast, Polanyi argues that marketization can have disastrous consequences for social integrity, so the society inevitably attempts to protect itself. When institutionalisation of protective measures is not attempted, they can drift to, or remain in, the informal realm. Hence, informal practices
reconfigure and transform to serve as a protection from the costs of marketization. Primarily in the cases when informal economic practices represent non-capitalist modes of integration, and when they are articulated against market economy in support of social integrity and reproduction, they cannot be expected to retreat as a consequence of deregulation. Moreover, forceful undermining of these practices can be very costly for groups and individuals dependent on informal practices. Alternative solution is to formalise and institutionalise protective measures, which would mean more, rather than less regulation.

The ethnographers studying post-socialist informality often underline that informal practices and institutions subvert, but also sustain market economy (Pasynkova, 2013; Ledeneva A. V., 2006 ). Informality helps sustain advancement of market economy, because in absence of state support, small scale informal practices of self-employed individuals ensure minimal social protection, hence prevent major social unrest and political stalemate. On the other hand, because these practices intervene with the workings of self-regulating markets, they also undermine success of formally institutionalised market economies. From Polanyian perspective balancing market enabling and market constraining forces is an extremely hard task even when it is institutionalised on state level. The question is, whether informally mobilised protective measures are not associated with higher risks and uncertainties compared to institutionalised protective measures. It is yet another question if governments are capable of institutionalising social protection, but unless they are, we cannot expect decrease in the importance of informality.
Bibliography


