

# Cross-border Small-scale Trading in South-Eastern Europe: Do Embeddedness and Social Capital Explain Enough?

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## Abstract

*The article analyses cross-border small-scale trading (CBST) from the perspective of New Institutional Economics. It offers an alternative analytical starting point to this topic, which is mainly tackled by sociologists and anthropologists. It is argued that concepts like social capital or social embeddedness can be of certain analytical use but that they hardly suffice to explain human behaviour in a detailed manner. The case of reference is the institution of bribery as it evolved in the first half of the 1990s at the Bulgarian-Turkish border.*

## Introduction

Sociological concepts such as social embeddedness,<sup>1</sup> social capital<sup>2</sup> and social networks have become popular among social scientists to explain human behaviour. Many of the authors in this field are related to New Economic Sociology. They apply these concepts to topics which are tackled by economists too. Granovetter (1985) popularizes the concept of the embeddedness of social action. He argues that in modern societies economic action is embedded into structures of social relations. He attacks both neoclassical economics and New Institutional Economics. Others, such as Aldrich and Zimmer (1986), apply these concepts to entrepreneurship, or, like Portes and Sensenbrenner (1993), examine the embeddedness of immigrant entrepreneurs.

In the sociological criticism of economic models, ideas such as social embeddedness and social capital have turned into catch-all concepts. Since each person is embedded in social networks and has some specific form of social capital, it is extremely likely that research on any particular topic will come up with the finding that social networks, social capital or social embeddedness do matter in one way or another. For instance, entrepreneurial success can easily be ascribed to the entrepreneur's social capital, i.e. to networks like family, kin, friends, acquaintances or co-ethnics. Such networks may provide unpaid labour or facilitate the raising of financial capital, or be sources of

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- 1 The authors working on embeddedness often refer to the work of Polanyi (*cf.* Polanyi, 1944 and Polanyi *et al.*, 1957). Compare additionally the critique of North (1977).
- 2 See Bourdieu (1986), Coleman (1988) and Portes (1998). The concepts of social capital, social networks and social embeddedness are not always precisely defined. A critical discussion on the social capital literature is provided by Sobel (2002). Recently, economists have been able to measure trust in experimental economics (*cf.* Glaeser *et al.*, 2000 and additionally Camerer 2003: 83-100).

information. However, the same networks can as well be used to explain entrepreneurial failure, for instance if quarrels among network members lead to loss of support. Thus, social capital and social embeddedness are considered to explain nearly everything — from entrepreneurial success to failure.

In this article I argue that embeddedness and social capital are insufficient concepts to predict behaviour and, in particular, that they are insufficient to predict entrepreneurial success. These terms scratch the surface of social phenomena that can be more thoroughly analysed with New Institutional Economics. For this purpose I have chosen a specific topic, cross-border small-scale trading as it has existed in Central, East and South-eastern Europe since the beginning of the 1990s.

Cross-border small-scale trading (CBST) was given particular attention by social scientists like sociologists and anthropologists who explained it partly with the social capital approach. This article offers an economic point of view on CBST. Microeconomic theory — based on rationally behaving agents and on methodological individualism — can offer useful approaches for analysing this phenomenon. I thus intend to enrich and, in certain respects, oppose the analysis of CBST provided by neighbouring social sciences. In order to illustrate the context of CBST I will refer to the situation at the Bulgarian–Turkish border at the beginning of the 1990s.

The article is structured as follows. In the first section I will give a brief overview of CBST. This overview includes a short review of the literature on CBST, which focuses on trading practices and open-air markets. The second section concentrates on the social capital approach, which has been employed to explain entrepreneurial behaviour in open-air markets. In the third I will draw attention to the essential part of the trading activities, namely, when traders together with their goods cross international borders. Their behaviour in this situation is vital for the success of the trade and their entrepreneurial endeavours. I will give a short description of the border crossing situation, which is borrowed from anthropological data. Section four draws on the concepts of rationally behaving agents and methodological individualism. I use approaches from New Institutional Economics to analyse this specific situation, thus employing a microeconomic perspective on foreign trade. In the conclusion I will argue that CBST and bribery are mainly based on rational individual behaviour and that the social capital approach and the concept of the social embeddedness of entrepreneurship are only partly sufficient to explain this mass phenomenon.

## **Cross-border small-scale trading (CBST) in Europe – an overview of the literature**

Small-scale trading across international borders has developed into a mass phenomenon in Central and Eastern Europe since the beginning of the 1990s. Millions of traders have crossed borders, mainly by bus, transporting goods in bags, sacks and suitcases, trying to sell them on open-air markets abroad. This specific type of trade is closely related to transitional processes. It is a highly visible reaction of people who suddenly find themselves amidst fundamental institutional change. The overwhelming majority of these traders were active within the former socialist countries. Few of them appeared as sellers in countries west of the former iron curtain, for example on the Polish markets (*Polenmärkten*) in Vienna or Berlin (Karazman-Morawetz and Pilgram, 1993; Weber, 2002) or in northern Norway (Thuen, 1993). In Western countries this trade was stopped soon afterwards when legal restrictions were implemented. But, while in Central European countries cross-border small-scale trading decreased at the end of the 1990s as they approached EU accession, it is still a prominent pattern of entrepreneurship in many of the countries in South-eastern Europe as well as in Russia, Ukraine and Central Asian countries.

The mass phenomenon of cross-border small-scale trading was first observed, mentioned and analysed by anthropologists. Later, sociologists followed to contribute

their share to the analysis. Economists, by and large, ignore this topic. They elaborate rather on topics such as macroeconomic stability and institutional change in transitional societies. What they do emphasize is the role of entrepreneurship in transition, but research mainly covers formal enterprises and formal entrepreneurial activities. McMillan and Woodruff's (2002) article on entrepreneurship in transitional economies, for instance, stresses the importance of entrepreneurship but focuses on formal small and medium-sized firms rather than on partly informally operating micro entrepreneurs (similarly, Johnson *et al.*, 2000; Berkowitz and DeJong, 2005). In economics, CBST is perhaps best subsumed under terms like informal or shadow activities.<sup>3</sup> Indeed, it is at times regarded as a type of criminal activity (Hajdinjak, 2002: 34–38). Despite the importance of CBST for transitional societies and for those people who make a living from it, it is not a major topic in economics: neither in neoclassical economics, nor in New Institutional Economics. This is surprising because the observation of CBST on the micro level provides a wealth of data on how people really behave in situations of radical and comparatively fast institutional change in industrialized countries and modern societies. The neglect of the topic by economists is even more surprising because economically it is not a marginal phenomenon in transitional societies. Eder *et al.* (2003: 5) note that traders from Eastern Europe accounted for a volume of 10 billion US dollars in Istanbul in 1995, Iglicka (2001) estimates that 500,000 Ukrainians regularly crossed the border into Poland for small-scale trade in 1995 and Konstantinov (1996: 773) mentions a sum of 500,000 US dollars paid in bribes per year by small-scale traders at the Bulgarian–Turkish border.

Illegal and semi-legal cross-border trading activities already existed in the former socialist countries before the iron curtain fell (Fish and Edwards, 1989). CBST, however, appeared as a mass phenomenon immediately after the opening of the borders between East and West. Very soon traders travelling by bus, rail or plane, established trade routes all over Eastern Europe and were also present at marketplaces in Germany, Austria and Norway. Old trade routes to the Far East, like the silk route, as well as new trade routes to the Middle East were established. In anthropological research the topic of CBST in Eastern Europe is brought up by Hann and Hann (1992) in a study on northern Turkey where they examine traders from the former USSR on open-air markets. Hann and Hann call this phenomenon 'trader tourism', a term indicating that these people cross borders pretending to be tourists while their purpose for travelling is trade. Other terms referring to people engaged in the same activities are 'shuttle traders', 'suitcase traders', 'cross-border petty traders' and 'international petty traders'. Another early anthropological record of this type of trade in Norway is provided by Thuen (1993). In Western Europe not only were legal restrictions on this business discussed, e.g. visa regulations for the travellers, but insightful descriptive material was also gathered about traders' motivations, strategies and behaviour (Karazman-Morawetz and Pilgram, 1993).

Further material (collected from the early 1990s) on small-scale trading and on open-air markets in the Southern Balkans is published in a volume by Konstantinov *et al.* (1996). Konstantinov (1994) already notes important aspects of CBST between Bulgaria and Turkey, highlighting the fact that members of a specific ethnic group (the Roma) have become especially successful in this business. The Roma are 'hunting for gaps through boundaries' (*ibid.*): they turn to semi-legal activities, hard physical labour and detection of new (entrepreneurial) chances comparatively more often than people of other ethnic origin in Bulgaria. This idea is further elaborated by Konstantinov and Thuen (1996) and Konstantinov *et al.* (1998). Apart from the intensive research on the trade route between Bulgaria and Turkey, descriptive material is also available about the

3 In many respects the approach of de Soto (1989) can be applied to CBST, too. See, for instance, Bantle (1994). For the size of the shadow economies in Eastern Europe *cf.* e.g. Schneider and Enste (2002).

trading routes (by bus) between Bulgaria and the countries of the former USSR (Ivanova and Michalev, 1996) and about trading between Bulgaria and Dubai (Egbert, 1996).<sup>4</sup>

While anthropologists focus on the trade in the southern Balkans, CBST is also a phenomenon apparent in Central Europe. Economic sociologists like Sik and Wallace studied the phenomenon and provide significant material on CBST (Wallace *et al.*, 1999) as well as on open-air markets (Czakó and Sik, 1999; Sik, 1999; Sik and Wallace, 1999). The description of CBST and the open-air markets is similar to that given earlier in Konstantinov *et al.* (1996).

Further research exists for other countries. Iglicka (1999; 2001) examined shuttle trading between Poland, Ukraine and Belarus. Williams and Baláz (2002: 328) focused on the activities at the border between Ukraine and Slovakia, doing research on selected persons whom they call 'gatekeepers' and 'facilitators', i.e. people who have the power to considerably influence the trading activities: border authorities, people from the political or the business sphere and others. Eder *et al.* (2003) conducted a survey on the suitcase trade between Russia and Turkey and on one of the largest and most important hubs in Istanbul, the *Laleli Market*. They show how the financial shocks of 1994 and 2001 in Turkey and of 1998 in Russia influenced CBST. Aidis (2003) carried out a survey on the largest open-air market in Lithuania, and Holtom (2003) elaborated on the cross-border trade between Kaliningrad and Lithuania, while Kaiser (1998) investigated traders at open-air markets in Uzbekistan.

## Social capital and CBST

CBST can be roughly divided into three stages. In the first stage the raising of capital, travelling abroad and purchasing goods are essential; the second stage is the transport of goods across international borders; the third stage covers the selling of these goods. The first and the third stages of CBST are closely related to marketplaces where the traders purchase and sell the merchandise. The social capital approach and topics of social embeddedness have been applied to the activities of traders on such marketplaces. An example is the contribution of Wallace *et al.* (1999).<sup>5</sup> They argue that CBST is a risky entrepreneurial activity because the traders are operating partly illegally. The risks which a trader faces include becoming a victim of untrustworthy business partners or of officials who exploit the weak formal protection of the traders. In the context of CBST Wallace *et al.* (1999: 752) argue that social capital can be applied by traders to reduce risk and to protect the gains of trade. One of their hypotheses is that 'in order to operate successfully, small-scale traders have to use social capital as a way of securing trust and this can be done through resorting to family networks, ethnic solidarity or friendship' (*ibid.*: 753). They investigate the risks and problems for small-scale traders while doing business (*ibid.*: 759–62). These include capital provision, changing state policies, obstacles presented by customs and police, threats by the mafia and thieves (*ibid.*: 759). They argue that the traders need to reduce these risks. Therefore, traders rely on resources provided by networks. Ethnic ties, family networks and the weak ties in social networks (friends) are identified as important factors for reducing risk (*ibid.*: 763–67). They conclude that 'economic activity is socially embedded in social, family and ethnic networks' (*ibid.*: 767).<sup>6</sup>

The statement that the traders' social capital and trust play their part in CBST is true. Many economists will probably agree that behaviour is embedded in social context (see,

4 Detailed descriptions of open-air markets in Bulgaria can also be found in Konstantinov *et al.* (1996: 7–49).

5 Other articles refer to Wallace *et al.* (1999), e.g. Williams and Baláz (2002: 328), Aidis (2003: 463). Kaiser (1998: 14–18) provides a similar argumentation on networking for the traders in Uzbekistan.

6 Other authors also attribute embeddedness to CBST. See Konstantinov (1994; 1996), Kaiser (1998: 15–16), Williams and Baláz (2002: 325).

for instance, Fafchamps, 2004 for traders in Africa). In other words, institutions, such as social networks like families, friends and loose acquaintances, play a role in people's decisions. This is also true for marketplaces where traders have to rely on trustworthy business sellers, middlemen or co-workers. A further strategy to reduce risk is to build up contacts with officials like police officers at marketplaces. For many of the traders engaged in CBST, it is certainly essential to establish such contacts in order to reduce risk, and social capital like ethnic ties or kinship may help in this respect.

Neither the approach used by Wallace *et al.* (1997; 1999), nor the problem of risk in cross-border trade is new. One may expect that the risk for these traders is extraordinarily high because their business is largely informal and partly illegal. Due to the informal aspect the traders cannot rely on protection by official institutions like the police or the law. However, the problems confronting informal trading activities are not that different from the problems affecting formal trading activities. For example, in non-transitional societies, e.g. in Western countries, formal institutions which protect cross-border trading are often non-existent too, or using formal institutions entails such high transaction costs that traders avoid them even when they do exist.<sup>7</sup> That is why, even in stable political states and societies, legal systems imply risks for traders. Hence, the insecurity in international trade is not a problem that is limited to informal CBST, or to transitional economies. In this case, as in other cases, institutional arrangements emerge in order to reduce the risk for traders and to ensure security.

Institutional arrangements among traders and their business partners are often based on social or cultural ties. In other words, the social embeddedness of international trading activities is not a phenomenon unique to CBST but is valid for many contexts of international transactions and has been examined in some detail. Greif (1993), for instance, gives evidence that informal institutions are established in international trade in order to reduce risks. He shows that traders in the eleventh century relied on social and economic institutions in order to control their agents and to limit opportunistic behaviour by these agents. He argues that traders deter their agents from opportunistic behaviour through a threat of collective punishment. Thus, culturally based institutions are able to reduce risk in trade and to provide security (*cf.* additionally Bernstein, 1992 for the diamond trade, Amponsem, 1996 for legal world-wide trading networks among Ghanaians, as well as Ben-Porath, 1980 as an early contribution).

Wallace *et al.* (1999) only slightly touch upon the second stage of CBST, i.e. the situation when traders cross international borders. This second stage of CBST needs a more thorough investigation, especially if the aim is to explain the economic success of these traders. CBST depends in many ways on the institutions established at international borders. Obviously, without a border CBST would not exist, and without additional institutions at the borders CBST would not work. It has been noted elsewhere that the border constitutes an important resource for those traders who are able to use it (*cf.* Bantle and Egbert, 1996 and Konstantinov and Thuen, 1996). Wallace *et al.* (1999) do not examine in detail the most sensitive part of CBST, i.e. the critical hours when the traders together with their merchandise cross international borders.<sup>8</sup> It is exactly this critical period when the behaviour of the traders decides whether or not they will be able to cross the border without harassment on the part of border officials, i.e. to import goods without being taxed. Since the transport of goods across borders under the guise of tourism is partly illegal, there is always the risk for the trader of legal or illegal action imposed by customs officials.

It is the border, its institutions for passage and individual behaviour that will be the topic of the next section. Economic anthropologists provide precise descriptions of the

7 *Cf.* the discussion on the territoriality of law in the New Institutional Economics of International Transactions (e.g. Schmidtchen and Schmidt-Trenz, 1990).

8 Social capital may also play a role at the border. There are hints in the literature that traders try to establish contacts with border officials (*cf.* especially William and Baláž, 2002; also Konstantinov, 1996; Wallace *et al.*, 1999).

mode of passage and of the institutions involved in border-crossing. Following on from this, I will outline the mechanisms and institutions established at the border between Turkey and Bulgaria in the first half of the 1990s. I will then seek to explain the behaviour of traders, customs officials and tour guides on the basis of the New Institutional Economics. Analysing anthropological material from this vantage point is not new and is also advocated by a few anthropologists (Ensminger, 1998; Acheson, 2002; *cf.* also Henrich *et al.*, 2001 for a promising symbiosis between experimental economics and anthropology). While Wallace *et al.* (1999) base their investigations on Central Europe, I refer mainly to observations in South-eastern Europe. To my knowledge, there exists no exact description of border crossing procedures for Central Europe in the first half of the 1990s, although there is some evidence that border crossing procedures in Central Europe have worked very much the same way as in South-eastern Europe. Williams and Baláž (2002: 327–30) conducted interviews with ‘gatekeepers’, among them border officials, in Ukraine and Slovakia. Williams and Baláž refer to Wallace *et al.* (1999: 762) and indicate that the mechanisms for bribing border officials in Central Europe are similar to those used in South-eastern Europe. They write (2002: 328): ‘In both cases, the border controllers are key gatekeepers, who can disrupt or facilitate the traders’ operations. The traders may negotiate individually with the border guards and customs officers, or via other gatekeepers such as tour operators’. Evidence of the mechanisms can also be found in Wallace *et al.* (1997: 17–18): ‘Trading often began as an organized trip with tourist buses being chartered and a group of people paying a portion of the costs. At the border they would each contribute a fee for bribing the customs officers’ (*cf.* also the interviews with traders in Wallace *et al.* (1997: 26–7; 1999: 766).

### Importing goods from Turkey to Bulgaria 1992–6: a case in point

CBST appeared most visibly after the permeability of borders in Europe underwent changes at the beginning of the 1990s. People used tourist visas in order to cross borders. The purpose of their travelling, however, was not tourism but trade. The bus was the most common transport vehicle. Istanbul with its markets full of cheap — not infrequently faked — western-style goods became a main destination of traders from all over Eastern Europe. Low purchasing prices were a precondition for considerable profits. Traders invested about 1,000 US dollars or more per trip. Considerable profits could be realized if the traders were able to import their purchases tax-free. CBST has many different forms, among them that of organized tours.<sup>9</sup> In organized tours traders are accompanied by tour guides and a travel agency arranges transport and accommodation. In the following, I will focus on organized tours between Bulgaria and Turkey, mainly between 1992 and 1996.<sup>10</sup>

9 CBST does not always take the form of organized trading tours with a tour guide. Some other forms of CBST could be observed, too. In these cases, individual haggling about the price for an untaxed border passage becomes necessary. The organized tour is, nevertheless, the most popular one (see also the footnote in Wallace *et al.*, 1997: 17–18).

10 What follows builds on Konstantinov (1994: 240–5; 1996: 769–77), Nedeva (1996), Kanchev (1996a), Ivanova and Michalev (1996), Konstantinov *et al.* (1998: 731–4), Thuen (1999: 742–4) and Egbert (2001). Furthermore, it is based on my own field notes collected by participant observation between 1993 and 1996 (Egbert, 1998). The CBST between Bulgaria and Turkey was only part of a variety of trading activities in the first half of the 1990s in the southern Balkans. The UN embargo against Yugoslavia, for instance, made small-scale trade of petrol highly profitable. For some time Bulgaria was also an attractive destination for traders from the former USSR who profited from the fact that the Bulgarian currency (the *lev*) was strongly overvalued (*cf.* Ivanova and Mihalev, 1996; Konstantinov, 1994).

The trade between Bulgarian cities and Istanbul worked as follows. In Bulgaria, traders registered with a travel agency or another organization offering organized trips to Istanbul. They paid a lump sum which included services provided by the travel agency. The latter was in charge of preparing and conducting the trip (Konstantinov, 1996: 771). First of all, the agency arranged a group visa for all passengers in the bus. Thus, the passengers in the bus were considered a collective entity at the border. Second, the agency chartered a bus. Third, it arranged a cheap hotel in Istanbul for two or three nights. The hotel was additionally used to store the purchased goods. Finally, a professional tour guide from the agency — most often a woman — accompanied the group and dealt with all the problems that might occur during the trip. Of special importance was her ability to ensure a smooth border-crossing procedure. In several cases she received assistance by the bus driver or other traders who together formed a leading subgroup within a bus (*cf.* Nedeva, 1996).

The travel from Bulgaria to Turkey posed no obstacles. The border controls on the way to Istanbul included passport and visa control and a rather superficial customs control. After arrival in Istanbul the traders had two days to buy merchandise. When the bus left Istanbul in the direction of the Bulgarian border, the most sensitive part of the trade approached: the hours at the border and the mode of border-crossing were decisive for the success of the business of all traders in the bus.

As a tourist, every trader had the right to import goods for personal use. The legally allowed maximum value of such duty-free imports changed several times at the beginning of the 1990s. For instance, in the early 1990s, goods up to the value of US \$300 could be imported duty-free by tourists (non-traders), provided the goods were considered for personal use. If the value of the goods was between US \$300 and \$1,500, they were taxed at 30% of their value. If a person had the status of a trader (through official registration of a company), all imports had to be taxed according to the laws (*cf.* for details Kanchev, 1996b: 82–5).

Not only did import regulations change permanently, but they also tended to be vaguely formulated and, hence, left space for interpretation by the customs officials (*cf.* Kanchev, 1996b; Konstantinov, 1996: 775). At the Bulgarian border traders coming from Istanbul had to fill in a customs declaration form. In this declaration form they usually announced that all purchased goods were for personal use, i.e. that they had nothing to declare. Thus they claimed to be tourists and not traders. They used several strategies to disguise their trading activities, for instance they filled in low prices or they circulated goods to non-traders on the bus if there were any (for details see Konstantinov, 1996: 776). Before leaving the border, each declaration form had to be stamped by the officials.

The business success of the traders largely depended on crossing the border with the status of a tourist and not of a trader. If the customs officials forced the traders to pay import tax on the items which they intended to import to Bulgaria, the expected profit of the trip would be spent and a loss might be made (Konstantinov, 1996: 771; Nedeva, 1996: 62). The prices of goods from Turkey at open-air markets in Bulgaria and elsewhere were only competitive if they were imported tax-free and the traders used arbitrage opportunities.

I will now focus on the procedures that ensured a smooth border-crossing. I draw on detailed information about bribing procedures provided by Kanchev (1996a), Konstantinov (1996: 772), Nedeva (1996), Thuen (1999: 743) and on my field notes when joining the traders. Before arriving at the border — normally around midnight — the tour guide collected money from all traders in the bus for the collective bribe. A trader had to pay according to the pieces of luggage he or she intended to bring undeclared across the border (about US \$2 dollars per item). Thus, a sum between \$200 and \$400 went into the hands of the tourist guide. At the border point buses with traders were considered as whole entities, and no individual bribing occurred on these organized tours. After passing the Turkish side of the border, a ‘theatre play’ began on the

Bulgarian side.<sup>11</sup> The traders filled in their customs declaration forms, and passports were controlled. Then, in some cases, the traders had to unload the bus and to queue beside their baggage. They had to wait before a customs official appeared. The tour guide handed over the collected declaration forms of the group indicating that there was 'nothing to declare'. The most sensitive part of the bribing procedure that followed did not occur in public. The tour guide — who acted as a go-between for the group of traders and the customs official — disappeared with the latter. They negotiated a collective bribe for all traders in the bus. The exact amount of cash that passed from hand to hand remained a secret between the two. If the last step of this wily process was successful, the tour guide returned to the nervously waiting traders, gave a sign to load the bus and it left for the Bulgarian hinterlands.

While this was more or less normal procedure as it occurred every night many times at Turkish–Bulgarian border points, cases are also known in which the border-passing did not go so smoothly. Konstantinov (1996: 776–7) describes a situation in which the customs officer rejected the bribe. The officer forced the traders to line up outside the bus and refused to stamp the declaration forms but instead demanded that three of the traders declare their goods (quoted in Konstantinov, 1996: 777). The tour guide then demonstrated her power over the customs official. 'In a spectacular loss of temper the guide suddenly begins to shout at the controller that her knowledge of how much each controller had accepted in bribes could put the entire brigade of controllers into prison' (Konstantinov, 1996: 777). The final solution to this incident was that only one of the traders in the bus had to pay duty on the undeclared imports. This trader was later compensated through repayment by the fellow traders for his or her financial loss.<sup>12</sup>

The brief description given above suffices to make clear that a successful border crossing, i.e. without paying duties, is critical for the success of the trip (Thuen 1999: 740). The institutions of border crossing are essential for the success of the traders in CBST. At these moments at the border, social capital may play its part, too, but the situation can more thoroughly be analysed with tools from New Institutional Economics.

## New Institutional Economics and bribery in CBST

The transitional processes have caused severe hardships for individuals. The literature on CBST leaves no doubt that most of the traders take to this form of business activity in order to improve their economic situation or that of their families. In Eastern Europe at the beginning of the 1990s transition brought in its initial stage a sharp slump in living standards for most of the people. In the early 1990s, for instance, Bulgarians experienced famine — an unprecedented situation in the years of socialism before. The engagement in CBST was one reaction to the drop in real income.

Most of the people became traders without enthusiasm. When they decided to start CBST, many of them were still employed as physicians, scientists, engineers, clerks, etc. They aimed to increase their income and often gave up their white-collar job and took up the physically strenuous activities of CBST. For some, CBST became a survival strategy in the transitional period. For others, like part of the Roma minority in Bulgaria,

11 Describing the situation at a border as a 'theatre play' or as 'fiction' is borrowed from Kanchev (1996a: 70), Konstantinov (1996: 773). Since everybody at the border knew that goods were transported untaxed across the border, the term smuggling would be incorrect.

12 It is not known whether customs officials had to fulfil a quota, i.e. to control a certain number of individual traders in the buses. Konstantinov explains the behaviour of the customs official in the following way: the official wanted to demonstrate in that particular situation that he is in power and that bribes are insufficient to bind him to any lasting treaty with the traders. The demonstration that he has the power to change the rules of the bribing is part of the game (personal information provided by Konstantinov, 8 December 2004).



CBST additionally allowed a return to traditional ways of life. For my purpose, it is assumed below that income generation was the motive for the traders to engage in these activities (*cf.* Konstantinov, 1996 and Konstantinov *et al.*, 1998 for CBST and social status, and Stewart, 1992 for the relation between trade and status among Roma horse traders in Hungary).

In the rest of the article I will examine the situation at the border described above, where the traders' entrepreneurial success largely depends upon their behaviour, the behaviour of their fellow travellers, that of the customs officials and the go-betweens (*cf.* also Bantle and Egbert, 1996). For the analysis I draw primarily on New Institutional Economics, which, in contrast to the neoclassical approach, considers transaction costs.

### Transaction costs

Institutions reduce risk and uncertainty and they lower transaction costs. The bribery system in the context of CBST can be understood as an institution that reduces uncertainty because it limits the range of possible actions of individuals and makes their actions partly predictable. Traders (especially on organized tours) can primarily rely on an established mechanism for crossing the border.

From the perspective of a trader, transaction costs arise when making use of international borders to transport merchandise across them. For instance, he has to invest permanently in up-to-date information about import laws and regulations. Since in CBST the trader accompanies his merchandise personally, he also has to invest in information about individual travel restrictions, e.g. visa requirements. For the trader it is costly to keep up-to-date information about laws and regulations. Especially, at the beginning of the transition period, foreign trade laws pertained to the socialist economies in the countries of the COMECON area.<sup>13</sup> These countries needed, in general, several years to adapt foreign trade laws pertaining to market-oriented economies. Furthermore, in the first years of the 1990s the legal restrictions on foreign trade were confusing due to a number of bureaucracies that implemented a variety of contradictory regulations (*cf.* for Bulgaria Kanchev, 1996b and Konstantinov, 1996: 775).

Nevertheless, formal regulations concerning foreign trade did exist (Wallace *et al.* [1999: 751], in contrast, state that the lack of formal regulations is accountable for the insecurity of CBST activities). However, they were outdated, repeatedly amended, and difficult to access for the traders; they were also open to a considerable number of interpretations by the customs officials. As a consequence, for small-scale traders it was nearly impossible to get details about import laws and regulations. Even if they could, the risk that customs officials would interpret the laws and regulations to the disadvantage of the traders' interests could not be eliminated. That is why it became a rational decision for the trader to look for an alternative institution that would reduce information costs and would allow an untaxed import of goods.

From the perspective of the customs officer the situation appears to be different. Generally speaking, at the beginning of the 1990s customs officials in most of socialist Eastern Europe had limited experiences with legal small-scale trading activities. Foreign trade, by and large, had been organized by state monopolies. At the beginning of the transition customs officers were also affected by decreasing living standards. CBST activities (together with the interpretation possibilities of laws and regulations) offered

13 COMECON comprised an 'economic organization from 1949 to 1991, linking the USSR with Bulgaria, Czechoslovakia, Hungary, Poland, Romania, East Germany (1950-90), Mongolia (from 1962), Cuba (from 1972), and Vietnam (from 1978), with Yugoslavia as an associated member. Albania also belonged between 1949 and 1961. Its establishment was prompted by the Marshall Plan. COMECON was formally disbanded in June 1991' (<http://www.tiscali.co.uk/reference/encyclopaedia/hutchinson/m0006083.html>).

them a chance to enlarge their income by accepting bribes. On the other hand, accepting bribes was connected with the risk of losing their (profitable) job at the border.<sup>14</sup>

For both the trader and the customs official, a rational decision was to choose an institution that could work with lower transaction costs than the applied laws and regulations. As a consequence, in the early years of transition in Bulgaria, a well-structured system of bribery evolved alongside the new form of mass-trading activities. The bribery system generated a higher income for the participants and reduced individual risks, because it allowed individual anonymity at the border through introducing middlemen (the tourist guides).

This institution relied on a tacit compliance between customs officials and traders. This compliance was to consider CBST not as a commercial activity but rather as an informal one (Bantle and Egbert, 1996). At the border, the traders pretended to be tourists. They strictly avoided indicating their professional business activities and filled in the declaration forms as if they were private persons. They did this despite the fact that many of them owned registered companies in Bulgaria. Crossing the border as a tourist (informal trading) implied lower costs compared to crossing the border as a trader (formal trading) (*cf.* additionally de Soto, 1989) because as tourists the traders avoided paying import tax. Thus, in their entrepreneurial activities, the traders switched between a formal and an informal status. Since at the border the costs connected to formality were higher than those of informality, traders used an informal status, and the customs officials, by and large, were ready to accept this status — after receiving a bribe. I will now look more closely at the arrangement between the two parties.

### Principals and their agents

A principal–agent relation comes into existence when a trader (the principal) engages a travel agency (the agent). The tour guide represents the agency on the trip. The traders rely on a tour guide for a smooth border crossing, where the guide is responsible for solving organizational problems for the traders. In particular, her<sup>15</sup> duty includes arranging a border crossing in such a way that the traders are accepted as tourists and that their imports are not taxed. The main part of the fee for the trip has to be paid by the trader in advance, *i.e.* at the time he enrolls for the trip at the travel agency. To ensure a smooth border-crossing the trader additionally gives money directly to the tour guide before the bus approaches the border point. Each trader contributes his share to this collective sum. This individual share is defined through the number of baggage pieces a trader carries with him. Afterwards, the tour guide can use this collective sum to bribe a customs official in order to let the bus pass.

Two aspects should be considered in greater detail. The first aspect is that problems may arise because a tour guide is employed by several traders. Some of them may try to free-ride at the expense of the others. This seems to be possible because the number of baggage items is not counted exactly by the tour guide. Some traders try to contribute a smaller share to the collected sum in the bus than a share corresponding to the actual number of pieces of baggage that they intend to be bring across the border. In consequence, the sum collected for the bribe may be too low and endanger the border-crossing procedure. The probability of such behaviour by single traders is limited on an organized tour. There is evidence that groups of two to four traders travel continually together (*cf.* Kanchev, 1996a: 66). Thus, in a bus there are several subgroups (*cf.* Nedeva, 1996 for the structure of a group) of cooperating traders who know how much merchandise the others have bought. Moreover, staying at the same hotel in Istanbul for a couple of days offers opportunities to get to know the fellow traders. In this way the

14 In the early 1990s the risk of losing one's job because of corruption seemed to be rather low in Bulgaria (*cf.* Kanchev, 1996b: 84). There is no record about hierarchies of corruption at the borders, *i.e.* that customs officials are forced by their superiors to extract bribes which they later have to hand over to the superiors.

15 Since the tour guides are mainly women, I use the feminine pronoun.

traders on such organized tours are not anonymous and they know very well how many pieces of baggage the others are transporting. At this point it is possible to refer to the embeddedness or the social capital of the traders. Identity within a small group limits the probability of using anonymity in order to free-ride (*cf.* e.g. Peters *et al.*, 2004 for experimental results on free-riding within families). That is why it is a rational behaviour when individuals rely on social capital (acquaintances, relatives, etc.) on the bus because it reduces the risk of suffering from opportunistic behaviour.<sup>16</sup>

The second aspect worth mentioning is that the tour guide can behave opportunistically after the traders have paid her. Since the contract between the tour guide and the customs official remains secret from the traders, a rationally behaving agent will try to retain as much as possible from the collected sum for herself and use the lowest possible amount for the bribe. This is an agency problem of asymmetric information. Traders are able to observe the result of the negotiations between the tour guide and the customs official — they either pay import taxes or not. Traders will not know how much the collective bribe was and how much of the collected money the tour guide took for herself. The tour guide may later simply exaggerate the sum she had to pay for the bribe, or she may invent reasons why problems with the customs official occurred. Nor will traders come to know why a bribe had not been accepted. Yet, a strong incentive shapes the tour guide's behaviour in the desired manner. This incentive to avoid opportunistic behaviour is the reputation of the agent. Traders travel with the same travel agency and the same tour guide if she has a reputation for being successful in arranging negotiations with border officials (Konstantinov, 1994: 242). If the agent is unsuccessful in the negotiations at the border, her reputation among traders is tarnished immediately. Since information about successful tour guides also spreads among traders (for instance at market places) and because many competing travel agencies exist, the loss of reputation can have severe consequences for the tour guide and the travel agency she works for. Traders are very careful in choosing an agent with a good reputation because a failure at the border could be disastrous for their entrepreneurial activities (Thuen, 1999: 743). Furthermore, the numerous organized tours with tour guides lead to increased competition, which prevents a tour guide from extracting extraordinary profits from the traders. If she charges the traders too much for a baggage item, then the trader will choose another travel agency on the following trip.

In the paragraphs to follow I will concentrate on the structure of the relationship between the tour guide and the customs official. Since it is the trader's free decision whether to employ an agent for the bribing or to arrange bribing individually (Williams and Baláž, 2002: 328) one can expect specific advantages (*i.e.* economies of scale) if traders employ an agent.

First, for the trader and for the customs official transaction costs are high if they haggle individually about a bribe. Especially for the customs official it would be a troublesome and time-consuming job to negotiate with each trader about the amount of the bribe. More importantly, it is rather unlikely that this could be done in a secret manner. Taking into consideration the transaction costs related to negotiations, it is more efficient for both parties to rely on a go-between who represents several traders. The

16 One incident was observed which does not seem to fit into the scheme of rationally behaving traders. That is the case described earlier in the article where one trader out of a group was forced to pay import duties while the other traders on the bus could pass the border without paying duties. Later that trader received compensation for his financial loss from his fellow travellers. This compensation was given voluntarily by the fellow traders and can be understood as a form of ex-post solidarity. It can only be rational if the traders expect reciprocity in case they are in a similar situation. However, since the traders in a bus do not establish a permanent trading group that will travel together again in future, it seems to be irrational to compensate someone with whom they will not travel again and from whom they cannot expect reciprocal behaviour. Nonetheless, it seems possible that the tour guide has the power to force the traders to compensate the scapegoat. Thus she can keep her reputation for being a successful guide and the reputation of her ability to protect traders in her group.

institution of the organized bribe with the money collection in the bus beforehand is less costly than individual bribes.

Second, the tour guide has access to information which the individual trader does not have and which is difficult and costly to get. Many of the tour guides worked during socialist times in professional fields that equipped them with knowledge about border-crossing procedures and with contacts to border personnel. Tour guides were typically former employees at state-owned travel agencies, like *Balkantourist* in Bulgaria (Konstantinov, 1996: 771; additionally Williams and Baláž, 2002). Here, for the tour guide, social capital in the form of contacts can be considered an advantage in negotiations. Additionally, the tour guides have specific knowledge about the structures and procedures at the border points, which most of the traders do not have. A trader may try to establish relations with a customs official individually but this involves substantial efforts. Wallace *et al.* (1999: 766) mention a case and describe it as a patron–client relationship that the trader uses to reduce risk.

Third, anonymity matters especially for the trader. Anonymity can also be understood as a risk-reducing strategy. The intermediation of middlemen secures a higher degree of anonymity for both parties. While a trader travelling individually cannot cross the border anonymously because he has to negotiate personally with an official, a trader as a participant in an organized tour is able to cross the border more or less anonymously inside the group (Bantle and Egbert, 1996). Thus, the risk of the individual trader becoming a victim of a rather arbitrary prosecution by officials is reduced. On the other side, the customs official is not an anonymous person, but it is only the exact amount of the bribe that remains a secret.

After having provided tentative answers about why a go-between is employed, I will now turn to the relationship between the tour guide and the customs official. For the tour guide this relationship is decisive for a successful negotiation and for perpetuating her reputation among her principals. If she fails to negotiate the bribe with the customs official, then she will lose her reputation. The customs official may either decide for the bribing system or he may perform his controlling functions as prescribed, i.e. apply the law and the regulations. In this respect Thuen (1999: 745–6) differentiates between ‘normative rules’ and ‘pragmatic rules’ that the customs official can choose between.

On the one hand, the customs official seemingly has a great power in negotiations because it is he who decides which institution is to be applied.<sup>17</sup> Furthermore, provided he decides to apply the prescribed laws and regulations, the latter will allow him a variety of interpretations about the imported goods (their value, commercial purpose), thus causing severe problems to a trader. On the other hand, since the customs official aims at maximizing his profits, he has to take into consideration the size of his official salary, the amount of the bribes and the risk of being punished for bribe-taking. Accepting bribes is rational to him if the risk of detection is relatively low and/or the costs of punishment are sufficiently low. The risk of being dismissed or being fined for bribery was comparatively low in Bulgaria at the time concerned.

17 But if we again go back to the case where the customs official insisted that three traders in the group had to declare their merchandise, the following claim could be made. Even if it seems that the customs official is in a more powerful position in the negotiation process than the tour guide because he is able to choose between applying ‘normative’ or ‘pragmatic’ rules (Thuen, 1999), the tour guide is not powerless. Since she represents all the traders in a bus, she can offer a substantial amount of money as a bribe (the collected sum in the bus was between US \$200 and \$400, amounting to much more than an average monthly income in Bulgaria in 1992). Moreover, in the case above, the tour guide tried to exercise pressure on the customs official, this threat being obviously regarded as part of the game. We can even conjecture further: maybe this theatre play is only staged for the traders and is based on secret agreements between the tour guide and the customs official. It could be played out to impress the traders and thus to augment the reputation of the tour guide.

Reputation is, nevertheless, also important for the customs official. An interesting question is why custom officials do not extract as much money from the traders as possible or why they are 'kind' to the traders. By 'being kind' I refer to the case where customs officials allow traders to pass through the border for a (moderate) bribe — even though the behaviour of the customs officials is often extremely humiliating for the traders. A tentative explanation is that customs officials compete with each other so that it is rational to be sometimes 'kind' to the traders, i.e. to accept moderate bribes as described. It is rational because there are many opportunities to cross borders and several border points through which merchandise could be transported into the country. In consequence, customs officials compete with other customs officials at other border points. If it becomes obvious to the traders that at a specific border point the customs officials always keep to the law or demand very high bribes, traders will immediately cross the border at other locations (or will use other modes of transport). Moreover, we can also assume that border officials cannot always accept bribes — even if they would like to. The reason is that if a customs official is 'kind' to traders (in order to enhance his individual income), revenues from custom duties for the state are zero. His dishonest behaviour can easily be detected by the lack of collected customs duties. In this way, even though customs officials would like to accept bribes, they are not always likely to do so.

The final question is why regulatory state authorities allowed traders and border officials this highly visible tax evasion and corruption. One possible reason is that CBST plays an important function in transition economies: it lowers the social costs of economic liberalization and structural adjustment; it supplies low-price commodities for consumers and creates income for border officials. It may thus stabilize societies in transition in general. Hence, the toleration of CBST and informal border-crossing has to be seen as the rational decision of politicians. Politicians have neither the budgets to pay high wages to border officials (or other state employees) and pensions, nor the budgets to pay unemployment benefits to other groups who engage in CBST (*cf.* Bantle, 1994; Bantle and Egbert, 1996; Egbert, 1998).

## Conclusion

CBST is a mass phenomenon of entrepreneurial activities related to the decreasing living standards in countries in transition. People who engage in CBST are motivated by material gains from this trade. Any trans-border business activity implies specific risks, and this also applies to CBST. Risk is limited if traders are able to rely on social capital (Wallace *et al.*, 1999). One can, however, pose the question whether social capital and the embeddedness of behaviour provides sufficient explanation in the context of CBST, or whether the critical remark of Portes (1998: 2) is true that 'social capital has evolved into something of a cure-all for the maladies affecting societies at home and abroad'.

I have argued that institutions influence individual decisions. A risk-reducing trader will certainly use social capital, like family bonds or acquaintances, at marketplaces and other places which are crucial for his business. But as institutions always matter, it would seemingly be too short-sighted to explain CBST only in terms of social capital. For this purpose, I have referred to the most essential part of the trading process for CBST traders, i.e. the time when they cross an international border. The case in point was the Turkish–Bulgarian border. I have used in a rudimentary way tools from New Institutional Economics (transaction costs, principal agent relations) to demonstrate that economists can contribute theoretical analysis to this important aspect of transitional economies, which, so far, has mainly been analysed by economic anthropologists and economic sociologists. If the concepts of social capital and embeddedness do not allow human behaviour to be predicted, then the theoretical value of these concepts remains limited. They rather explain human behaviour *ex-post*. New Institutional Economics

instead offers a framework to analyse specific situations more precisely and to predict *ex-ante* how people will behave. The catch-all concept of social capital may then be easily 'embedded' into approaches of New Institutional Economics.

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## Résumé

*L'article examine le petit commerce transfrontalier dans l'optique de la Nouvelle Economie institutionnelle. Il propose un point de départ alternatif à l'analyse de cette activité, laquelle est traitée principalement par des sociologues et des anthropologues. Dans une analyse, on peut recourir à des concepts tels que le capital social ou l'intégration sociale. Pourtant, ils suffisent rarement quant il s'agit d'expliquer en détail le comportement humain. L'exemple de référence est celui de l'institution de la corruption et son évolution pendant la première moitié des années 1990 à la frontière turquo-bulgare.*