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## Social capital and economic development: The case of Uzbekistan

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Arbeiten aus dem



# OSTEUROPA-INSTITUT REGENSBURG

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## **Social Capital and Economic Development: The Case of Uzbekistan**

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## **Abstract**

While most transition countries suffered substantially from the world financial crisis of 2008 and still cope with its consequences, Uzbekistan has stayed almost untouched and shows constant economic growth since 2001. Neither macroeconomic foundations nor available institutional indicators provide an explanation for the sustained “Uzbek Growth Puzzle” (Zettelmeyer, 1999). This paper argues that social capital plays a major role in this puzzle. I examine how social capital has contributed to (1) the ease of transition, (2) the development of effective markets and (3) the development of an effective government. In view of the empirical results from other countries, I analyze the Uzbek case with the help of stylized facts for Uzbek social capital and the data derived from the AsiaBarometer surveys for 2003 and 2005.



## **1 Introduction**

The so-called “Uzbek Growth Puzzle” (Zettelmeyer, 1999) is still challenging conventional wisdom. In 1990, starting conditions for transition to a market economy were not favorable for the country. Within the Soviet Union it served as a food and cotton production unit with only a minor industrial sector. Geographically, it is located far away from the promising western markets. The traditional trade infrastructure has been disrupted, and China’s cheap labor and goods are close. However, according to official statistics, Uzbekistan experienced the mildest output decline among all transition countries, and it was the first to succeed in reaching its pre-transition output levels again in 2001. Since that time, we have been observing steady economic growth but almost no reforms, in contradiction to the hypotheses of the Washington Consensus. While the Uzbek growth data used in Zettelmeyer’s (1999) regressions are, due to poor quality of official statistics and due to political influencing, as questionable as they are hard to verify, other indicators of development in a broader sense are not. Exports are booming, but trade is still under state control. Legal institutions have been extensively developed, but governance is poor. The country is a permanent statistical outlier in all cross-country studies which examine the interplay between institutions and development.

In this paper, I suggest social capital as a missing factor. Many studies have demonstrated that a high level of social capital asserts a positive influence on development by reducing agency problems and information costs within a society. The starting point is that Uzbekistan, contrary to other transition countries, is a society based on high levels of social capital. This has been shown by historical, ethnological and sociological research which is reflecting the “Asian Values” debate. A masterpiece of collusive social capital “at work” during Soviet times of Uzbekistan was the cropping, harvesting, processing and marketing of millions of tons of cotton that had never ever existed. For the purpose of this paper, I limit the research to findings that can be derived from sociological participant observation of the status quo of Uzbek society, surveys of the Asian Development Bank carried out in 2003 and 2005, case studies and linguistic and ethnological studies hereon.

How can social capital influence the economic development of a country? Empirical evidence on social capital and economic development shows a great variety of such channels. Several of them might be relevant for Uzbekistan, such as the decisive role of the family in overcoming problems with credit constraints, with finding a job or with imperfections in goods and health markets. However, when examining possible implications for Uzbekistan, there are some caveats that should be kept in mind. First, cross-country data sets used for measuring social capital and the specification of the regressions used are built on cultural norms of (western) authors and might omit factors that count in non-western societies. Second, for countries in transition, the historical momentum has to be added (Fidrmuc and Gerxhani, 2004). A person deprived of its past skills and gains and sometimes even of the former home country has a different perception of general trust than a Western European citizen of the 1990s. Third, research on economic effects of social capital is still limited and sometimes even contradictory.

The paper proceeds as follows: Section 2 offers a short definition of the social capital concept as understood in the paper, a description of the mechanism and channels that make social capital work in an economy and information on measurement of social capital including the database for Uzbekistan. Findings from cross-country to narrow case studies and their possible implications for the Uzbek case are presented in Section 3. Section 4 applies these findings to stylized facts of social capital in Uzbekistan corroborated by data, country studies and observations from other fields of science. Section 5 concludes and puts forward questions for future research.

## **2 Social Capital: The Missing Factor in the Uzbek Growth Puzzle?**

### **2.1 Notion of Social Capital and Stylized Facts for Uzbekistan**

According to the World Bank definition of social capital as the “institutions, relationships, attitudes and values that govern interactions among people and contribute to economic and social development” (Grootaert and van Bastelaer, 2001), social capital has an effect on development. However, there are as many definitions of social capital as there are disciplines (sociology, economics, political science, ethnography) and scholars who have been dealing with it since the beginning of the 20<sup>th</sup> century. In economics, the concept of social capital became prominent nearly at the same time as the concept of governance, with Coleman (1990) providing the first theoretical links between social capital and economic development. For the purpose of this study, the main starting point is that “what is between people” constitutes “capital”. It requires a time investment to build it up, it depreciates if no new investment is made, and it produces a stream of benefits (or losses) for the investors and/or the community.

The World Bank Social Capital Initiative that started its work in 1996 has been the promoter of many empirical studies in this field. Following the broad approach of the World Bank Social Capital Initiative, the scope of social capital stretches from the (1) micro level of interactions between individuals, households and firms building groups and associations to the (2) meso level of vertical or hierarchical interactions within and between groups and to the (3) macro level of the social and political environment and institutions that influence the social structure.<sup>1</sup> In an even broader definition by Collier (1998), a distinction is made between “government social capital” and “civil social capital”. The former is identified as governmental institutions that influence people’s ability to cooperate for mutual benefit. As government social capital is empirically measured by indicators of political freedom, rule of law and stability indicators, the proximity of this type of social capital to the “governance” concept and its weaknesses in the Uzbek case are obvious. Hence, for the pur-

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<sup>1</sup> Authors associated with these concepts are Robert Putnam (1993), James Coleman (1990), Douglass North (1990) and Mancur Olson (1982).

pose of this paper, I neglect the dimension of “government social capital” and focus primarily on the micro and meso level of social capital.

The distinction between formal and informal social capital plays an important role. *Formal* social capital constitutes a public good (a good that is available to everybody at no cost). For example the procedures of decision-making through established rules, or the shared attitudes toward corruptive practices or a general “trust” in institutions and politics. In this sense, formal social capital improves the efficiency of formal institutions such as laws. Additionally, it diminishes the necessity and thereby the costs of third-party enforcement of formal rules – less control is needed and fewer lawsuits are necessary if people trust and respect the formal rules. In contrast to formal social capital, informal social capital represents the personal “connections”, or the belonging to groups, or the individual “trust” in certain persons, and this is not available to everybody. It constitutes a private good, and outsiders can be entirely excluded from the use of this good.

The second taxonomy important in the context of this paper is the difference between bridging and bonding social capital. If people interact with similar individuals or groups along horizontal lines, they develop bonding social capital. If the interaction takes place via hierarchical (vertical) lines, then bridging social capital is developed. Again, possible exclusion of outsiders plus possible collusion along certain lines shapes the environment of economic interaction between individuals. Thus, while social capital opens possibilities for making economic interaction more effective, it also bears the possibility for misuse.

In Uzbekistan, based on participant observation in the empirical literature given below, at the micro and meso level, the following stylized facts of social capital can be traced: people respect authority, obey traditions, have strong family ties and rely on personal relations and trust. The first two – obedience and tradition-orientation – constitute formal social capital. The last two – strong family ties and the importance of personalized trust – constitute informal social capital. At least one (family ties) is bonding, and at least one (personal relations) may be bonding or bridging. All of them can influence economic outcomes in different ways.

## **2.2 How Does Social Capital Affect Economic Outcomes?**

*Micro-economic channels.* Starting with the notion of information externalities created by social interactions among individuals, Paul Collier (1998) distinguishes three micro-economic mechanisms of social interaction: (1) social interaction makes other agents observable and thus reduces the problems of opportunism, (2) social interaction promotes the exchange of knowledge of technology and markets between the agents and thus reduces problems of incomplete information and (3) social interaction reduces the problem of free-riding and hence facilitates collective action. If these externalities of social interaction are durable, “social capital” is generated.

Generally speaking, social capital reduces information costs, transaction costs and risk, and diminishes the problems of moral hazard and adverse selection. In transition economies with huge informational problems at the end of the plan mechanism, all these elements play a very important role, as shown by empirical studies. Whenever flexibility – a rapid adaptation to more fragmented and variable markets – is needed, social capital and tacit knowledge are an advantage. Trigilia (2001) demonstrates this for developed countries transiting from the Fordian-Keynesian model of social organization to the era of globalization.

*Macro-political channels.* One strand of social capital literature is devoted to the research on social capital in institutions and how it fosters good governance and development. This literature stresses the importance of social capital for poverty alleviation and income distribution. It has been empirically shown that social cohesion and civic engagement can improve the quality of economic policies and promote the efficiency of public administration (Putnam, 1993; Easterly and Levine, 1997).<sup>2</sup> This “improved-governance-channel”, however, might not be relevant for countries like Uzbekistan because of differing perceptions of social cohesion and differing norms on good governance. Some authors recall the producers (individuals who produce new

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<sup>2</sup> Putnam’s seminal paper is on variations in economic performance in Italian regions (1993); Easterly and Levine’s (1997) is on Africa.

wealth) versus predators (individuals who divert wealth produced by others) models of Grossman (1998) and test the hypotheses that social capital determines the relative payoffs of production and predation and hence influences income distribution (e.g. Knack, 1999). Since the ratio of producers and predators as well as the social cost of predation depends on whether the decision to invest in guarding against predators is made individually or collectively, this idea seems quite striking.

*Effects on human capital, health and happiness.* Sociologists, anthropologists and political scientists research mostly the macro and meso levels of social capital along the lines of norms, networks and organizations up to governance-related questions. A main strand of literature deals with the interplay between social capital and human capital. In his seminal paper, Coleman (1988) argues that religiously based High Schools, which are associated with having a high degree in community-backed social capital, have much lower dropout rates of students. A second and even more “ancient” line of literature deals with the positive impact of social capital on health. It dates back to 1897 when Durkheim identified a relationship between suicide rates and social integration in his seminal contribution. In the three-level approach of the World Bank Social Capital Initiative, at the macro level, health care provision is more efficient when all groups of health care actors interact smoothly. At the meso level, social capital can help to change damaging social norms, e.g. smoking. At the micro level, information on health becomes less costly and personal relations act as a last resort. A rather recent strand of literature discusses the effects of social capital on happiness showing a positive impact that is relative to economic growth.<sup>3</sup> In a study conducted by Kalyuzhnova and Kambhampati (2008) on the determinants of happiness in Kazakhstan, it has been shown that happiness was not lower for people living in regions of high unemployment. The reason was that those individuals did not feel marginalized due to high levels of social capital within the community and due to the shared fates in their reference groups.

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<sup>3</sup> For more information on social capital and happiness see Putnam (2000) and for more information on happiness economics see Easterlin (1974).

*Negative social capital.* As noticed earlier, one has to be aware of the fact that a high degree of social capital does not necessarily constitute benefits alone and is not necessarily a benefit for a community or a nation as a whole. The sociologist Banfield (1958) was the first to demonstrate the negative effects of a family-concentrated narrow self-interest on economic development, recalling the poor Italian South. In contrast to Putnam (1993), Olson (1982) was very pessimistic about the effects of group interaction on economic development. Therefore, the distinction of the character of a group – an altruistic “Putnamesque” group versus a rent-seeking “Olsonian” group – has to remain clear. The effects of the different group characteristics on development are contradictory as the literature shows; the overall result is determined to a great extent by cultural and institutional factors.

In general, it is mostly informal social capital at the micro level that may turn into “negative social capital”. Portes (1998) lists four examples of negative social capital “at work”: exclusion of outsiders from benefits, excess claims on group members, restrictions of personal freedom and downward leveling of norms. Formal social capital has negative potential as well, but these questions are less researched. The negative influence of social impediments on earnings mobility, which is a serious problem in Uzbekistan, is shown in a theoretical model by Galor and Tsiddon (1997). As another example for formal negative social capital, one may recall that a general attitude to rely on networks in the business sector may hinder enterprises in expanding their business and hence be an obstacle to overall economic development.

### **2.3 Measurement of Social Capital and Uzbek Data**

Empirical research on social capital is shaped by measurement problems. Most studies use one of the following proxy indicators for social capital: (1) membership in associations and networks, (2) indicators of generalized or kinship-based trust and adherence to norms and (3) indicators of collective action. While the first indicator is an input indicator, the second is very close to what social capital really is. Collective action, on the other hand, is an indicator measuring the output of social capital. For the first two concepts of indicators, several databases covering many countries can be accessed.

Most prominent for measuring membership and trust components of social capital is the World Values Survey (WVS). Other surveys like the Living Conditions, Lifestyle and Health Survey (LLH) provide more information on the results of social capital.

The validity of these indicators for countries in transition should be interpreted carefully. Indicators of membership and trust in transition countries are strongly related to the Soviet past and to problems of a nascent society and government failures – hence they may reflect a “transitory perception” of social capital and not the actual stock of social capital of the country. For Central Asia, namely Uzbekistan and Kazakhstan, a recent study by Radnitz et al. (2009) shows that “trust and norms” diverge from “networking” when regimes are repressive and the influence of development interventions by aid is high. Therefore, both indicators, although often treated as substitutes, should be kept apart.

Uzbekistan is not included in the cross-country databases described above. On a nation-wide basis, the Japanese AsiaBarometer initiative has collected survey data of 800 respondents from all regions in Uzbekistan in 2003 and 2005. The surveys include several questions on values and norms and some social capital related questions.<sup>4</sup> Serious weaknesses of this survey are the exclusive focus on cities (caused by political, time and budget constraints) and the lack of adequate census information at the statistical offices in Uzbekistan. Given the fundamental economic differences between urban and rural living conditions and their impact on the lifestyle, habits, norms and behavior of Uzbek people, the survey data may be biased and have to be interpreted with caution. Another weakness related to the present study is the limited comparability of both surveys with respect to the income conditions of the respondents: in the 2005 sample, the percentage share of rich respondents is substantially higher than in the 2003 sample. A descriptive statistical analysis of relevant aspects of both rounds is undertaken by Dadabaev (2004; 2007). Main findings of both surveys in general corroborate the stylized facts and will be discussed below.

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<sup>4</sup> For more information on the AsiaBarometer see Inoguchi and Fuji (2007).

On a regional basis, two case studies based on survey data provide insight into some aspects of social capital in Uzbekistan. With a sample size of 83 respondents surveyed in three cities in 1999, Sievers (2002) examined the role of Uzbek *mahalla* as a residential regime in the decision-making of individuals when buying a house in a certain *mahalla*. Wegerich (2006) examined the role of network links in reaching the position of a farm manager and in losing this position again in semi-structured interviews of 51 farm managers carried out in 2003 in two sub-regions. Additionally, a small basis of existing fieldwork by ethnologists and sociologists on social capital in Uzbekistan, based mostly on unstructured interviews and participant observation, provides more or less anecdotal evidence.

While all these studies add empirical evidence on the stock and role of social capital in Uzbekistan, they do not provide quantified insights into the economic effects of these settings. However, taken together, these studies help to structure the stylized facts and allow adding at least a sign to their expected effect on economic results. Quantifying these effects remains a task for future research.

### **3 Lessons from empirical literature and implications for Uzbekistan**

#### **3.1 Determinants of Social capital**

Cultural explanations of driving factors behind social capital provide valuable information on the stock of social capital in a society, especially when data are scarce or lacking as in the given case. For religion, Guiso, Sapienza and Zingales (2003; 2006) based on the WVS and the US-wide General Social Survey, state a strong and positive influence of being a Catholic or Protestant on the level of trust, while being a Muslim (as most inhabitants of Uzbekistan are) does not have this effect. However, their results contradict earlier findings of Alesina and La Ferrara (2000a) who cannot trace a significant correlation between religious beliefs and trust. Instead, they identify traumatic experiences and discrimination, racial segregation and high income disparity as well as missing educational and economic success to be the determinants of low trust. According to the findings presented in both papers, Uzbekistan as a homogenous and – according to official data – relatively egalitarian country qualifies as a “high-trust-country” as assumed above.

The determinants of group membership are modeled by La Ferrara (2000b). She investigates the effect of income inequality on group membership and finds out that with an increase in inequality, membership in open groups generally decreases while participation in restricted groups grows especially among the middle and upper income classes. Thus, with income gaps widening during transition, in Uzbekistan, we may expect “general” membership to decrease, and membership in “closed circles” to increase. Radnitz et al. (2009) contribute to the discussion by comparing different cultural backgrounds in Kyrgyzstan and Uzbekistan. Using data collected from 2000 surveys carried out in 2005, they come to the conclusion that social interaction is higher in less repressive regimes, whereas trust and norms are higher under greater repressions.

### **3.2 Cross-country and cross-regional evidence**

The mainstream empirical literature concentrates on the indicators “trust” and “membership” and captures the micro and meso level of social capital. The studies generally report a positive correlation of trust and economic development, but most papers include only industrialized countries. Built upon cross-country data from the WVS for 29 market economies, Knack and Keefer (1997b) find a strong positive association with investment and economic growth for anonymous or extended trust. Guiso, Sapienza and Zingales (2004) find for European countries that trust matters for trade in goods, financial assets and foreign direct investment. Trusting increases the probability of being self-employed and high-trust countries have higher saving rates (Guiso, Sapienza and Zingales, 2006). For “membership” the results are very mixed (Knack and Keefer, 1997b; Knack, 1999).

The economic role of the family is researched extensively. Fukuyama (1995) argues that trust in the extended family was decisive for growth in China. Geographic mobility of individuals is reduced by strong family ties, as Reher (1998) shows for European countries. In developing countries like Uzbekistan, the family often acts as a substitute for imperfect or missing credit markets (La Ferrara, 2003; Ronnas, 1996).<sup>5</sup> Similarly, family business helps to overcome imperfect goods markets and information problems along the supplier-consumer chain (Ronnas, 1996). Unemployment shocks are less severe for individuals living in countries with strong family ties, as Bentolilla and Ichino (2008) show. A recent study by Alesina and Giuliano (2007), using data from the WVS for more than 70 countries, highlights the role of the family in the most encompassing way. With families being larger and the individuals less mobile due to strong family ties, the reliance on the family as an economic unit providing goods and services is stronger than the reliance on the market for purchasing goods and on the government for social insurance.

A broad set of cultural components fostering economic development has been tested by Tabellini (2005). He defines generalized trust, belief in individual effort, generalized morality and non-obedience (!) as cultural components fostering economic development

and provides strong evidence for this hypothesis with WVS data – but only for European countries. However, it has to be mentioned again that the specification of the regressions run by Tabellini (2005) and other authors are built upon cultural preferences of the authors, which might be questionable if non-European societies are under consideration.

At the macro level of social capital, literature focusing on the effects of ethnic divisions and social conflict corroborates the hypothesis that nations with low latent conflicts and effective institutions of conflict management more easily adjust to exogenous shocks (Keefer and Knack, 1995; Easterly and Levine, 1997; Rodrik, 1999). In Uzbekistan, the effect of this kind of social capital since independence in 1991 is clearly positive. Ethnic homogeneity helped the country avoid civil conflicts like in war-torn Tadjikistan. However, with growing inequality, social conflicts are on the rise, as upheavals like the ones in Andijan in 2005 demonstrated. As mentioned earlier, I do not focus my research on the government social capital for several reasons, so this component is not included in the stylized facts.

### **3.3 Evidence from case studies**

Case studies provide information on how social capital at the local level can help to overcome problems of informational imperfections, opportunism and free-riding. Relational contracting based on trust and reputation and its positive impact on income and growth are fairly well researched (Greif, 1993; Fafchamps and Minten, 1999; Reid and Salmen, 2000).<sup>6</sup> Recalling the stylized facts for Uzbekistan, the observed high level of “relational contracting” (people rely on personal relations and trust when contracting) should assert a positive influence on economic growth, especially in local and regional business or small and medium enterprises.

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<sup>5</sup> La Ferrara shows this for Africa and Ronnas for Vietnam.

<sup>6</sup> Greif on historical merchant guilds in Mahgreb, Fafchamps and Minten on agricultural trade in Madagascar; Reid and Salmen on agricultural extension in Mali.

Several studies shed light on the question how social capital helps to overcome imperfections of the credit market and improves the access to credit for poor people.<sup>7</sup> The majority of these studies examine the influence of the reputation mechanism on selection procedures of banks, on the banks' costs of monitoring the financed projects ex post and on credit repayment rates. The higher and easier the "observability" of possible projects, ongoing investments and actual repayment, the easier and the cheaper is access to credit for people. Like in many other countries (the first-mover was the Grameen-Bank in India), Uzbekistan's micro-financing projects, supported by international financial institutions, make use of these mechanisms that rely on social capital.

For local Indian communities, Pargal, Huq and Gilligan (1999) show that communities with strong social capital are more likely to organize an efficient collection of waste on a voluntarily basis. The same can be observed for Uzbekistan, as we will demonstrate for the Uzbek *mahalla* (neighborhood) below. Privately organized waste collection is an asset promoting health and thus helps to avoid costs related to illness not only for the individual but also for the state budget. Additionally, this kind of "privatization" of public tasks in low-income societies allows budgetary financing to be directed to investment or other purposes more relevant for economic development. However, if the amounts saved are not invested in an efficient manner, misused for populism or prestige-projects, the effect for economic development could turn to negative. Moreover, it could have negative consequences for governmental institutions that tend to rely on private collective action taking and prove helpless or unwilling should this habit come to an end.

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<sup>7</sup> See van Bastelaer (1999) for a literature overview.

### 3.4 Evidence from transition economies

Economic research on social capital in transition countries is very limited to date. Raiser (1997; 1999) examined the role of informal institutions and social capital in transition economies in several contributions. In his first paper, he opposes the transition strategies of the “strong states”, China and Eastern Germany (Raiser, 1997). Similar to Fukuyama (1995), Raiser (1997) asserted that in China the extended family contributed to the successful agrarian reforms as the source of Chinese growth, whereas in Eastern Germany the trust in formal institutions took the lead. According to the stylized facts for social capital in Uzbekistan (“strong family ties”) and the importance of the agrarian sector for the country, we expect the influence of social capital on economic development to be comparable to that in China. However, it is not clear to what extent Uzbekistan qualifies as a “strong state”, since we find evidence that state agencies are poorly informed or betrayed, e.g. on cropping schemes. In his later paper, Raiser (1999) identifies extended trust in governmental institutions and law enforcement as means of overcoming closed social and business networks that, according to theory, may constitute negative social capital and reduce competition. This hypothesis is tested for 21 transition countries with different data on trust and civic participation derived from the WVS 1995, the New Democracy Barometer (NDB) and the EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS-Survey) 1999. As expected, the level of generalized trust in transition countries measured by the WVS is lower than the OECD average and even much lower than in China. The same can be observed for civic participation in different organizations. The level of trust in institutions, however, as measured by different sources is not lower than in mature market economies. The somewhat surprising result of the growth regressions is that, unlike in market economies, generalized trust to other people as measured by the WVS is not relevant to economic growth in transition countries. On the other hand, trust in institutions as measured by the BEEPS, especially trust in the legal system and the police, does matter for growth in transition. This result should hold true for closed business networks in Uzbekistan – the more people trust in government institutions, the more the influence of closed networks should decrease.

Several empirical social capital studies focus on Russia. Most of these studies are devoted to political questions and use aggregated economic indicators to trace the “improved governance channel”, which is not in the focus of this work, but it provides background information. Some studies research the relation between social capital and “imperfect” nascent markets. The exercise by Marsh (2000), who examined the stock of social capital and its links to democratization in Russia following the method of Putnam’s (1993) civic community index belongs to the first category. In Marsh’s (2000) civic community index, newspaper readership as used by Putnam (1993), is substituted by newspaper production data available for Russia – an approach clearly not appropriate for autocratic countries like Uzbekistan. According to Marsh (2000), in Russia, the stock of social capital varies substantially in different regions like it does in Italy. Moscow and its neighboring regions around show the highest scores while the northern part’s scores are the lowest. Although the methodology seems questionable in some respects, the existence of regional differences in social capital surely does not. Hence, existing regional case studies and non-representative survey data for Uzbekistan should be interpreted with caution.

The exercise to identify regional social capital as a source of regional economic growth undertaken by Moran and Buttrick (2005) failed nevertheless. Their simple regression of Marsh’s regional civic community indices on regional GDP in Russia showed no significant correlation between regional growth and regional social capital. Instead, the amount of entrepreneurial activism as measured by the number of small and medium enterprises in a region is highly correlated with regional development, which does not come as a surprise. Their conclusion is that social capital does not matter for regional differences in growth while entrepreneurship does. This result seems questionable since the regressions neglect causality problems and are not controlling for other regional economic variables like endowment with natural resources, distance to the centre or quality and quantity of higher education institutions available in a region.

A carefully designed household survey of almost 2000 adult Russians analyzed by Rose (1998; 1999) revealed that in the Russian-style transition economy, the majority of private individuals clearly relied more on informal social networks, bribing and using

“connections” to get access to goods – with the exception of food – and services, than they relied on markets. In fact, in several fields, the market mechanism is substituted by social capital. The reason behind this behavior of individuals is identified as the inability or unwillingness of the government to impose the “rule of law” in an efficient manner. For Uzbekistan, which also shows poor “rule of law” scores according to the World Bank Governance Indicators 1996–2009, we expect comparable strategies of consumers and hence problems with the creation of markets. Somewhat puzzling is the fact that, according to the World Bank Doing Business Surveys 2004–2009, the businessmen surveyed in Uzbekistan have a positive perception on their ease of doing business in the country. That implies that either rule of law is properly enforced by the government or that social capital at work is substituting the rule of law and government functions. It might therefore be relevant to keep in mind a distinction between consumers’ and producers’ markets when asking for the role of social capital in the country.

At the firm level and thus for producers’ markets, Batjargal (2000) used panel data from 75 Russian entrepreneurs interviewed in 1995 and in 1999. He shows that social capital in the dimensions of “relational embeddedness” (belonging to closed business networks) and “resource embeddedness” (resources delivered to the enterprise by state institutions) has direct positive impact on enterprise performance while “structural embeddedness” (belonging to administrative structures such as line ministries) has no growth impacts. The differing effects of disaggregated indicators of entrepreneurial social capital demonstrate that firm level research into social capital requires a historical and structural contextualization and, especially in countries with nascent markets, is better left to case studies.

## **4 Synthesis: How Does Social Capital Work in Uzbekistan**

### **4.1 Formal Social Capital: Authority, Traditions and Economic Development**

#### **4.1.1 Respect towards authority**

A societal inclination to accept authority constitutes an asset belonging to the bundle of formal social capital and represents a public good available for every person living in the community. No primarily relevant question concerning authority is asked in the AsiaBarometer surveys. However, the most important wish parents express for their sons is “to become a person respected by masses” with 39.9% of parents giving highest preference to that wish in both 2003 and 2005. Becoming a loving and charitable person is of great value to only 33.6% and 27.1% of parents in 2003 and 2005 respectively.

Evidence of the acceptance of authorities can be found in the very nature of the Uzbek language. Children and adolescents address their parents and elder people in the third form, often even in plural. Further evidence is the Uzbek institution of *aqsaqaly* (“white beards”). *aqsaqaly* are male, elderly and highly respected people, who perform the tasks of “senior consultants” in many aspects of the everyday life in Uzbekistan. As a matter of fact, *aqsaqaly* make decisions not only on folk songs and in families but also in ministries and enterprises.

With respect to economic development, the societal inclination to accept authority means that obedience to rules – be it of formal or informal character – is high. This is obviously useful for good governance. It may explain to a certain extent the good perception of governance among Uzbek businessmen. Second, good governance may explain growth to a certain extent. International organizations, who can observe only the implementation of formal rules, perceive governance as poor.

Obedience may constitute a negative asset as well, as assumed by Tabellini (2005). Obedience could be an obstacle to the open discussion needed for development and adaptation of new ideas and technologies. This would hinder the mechanism of “creative destruction” in the development of an economy. However, the example of

the successful Southeast Asian countries that can be also qualified as “obedient” demonstrates that many factors influence how a society deals with new ideas. In the non-democratic environment of Uzbekistan, where constructive criticism is suppressed together with any other critical expressions, the possibility of the suppression of new ideas is higher than in democratic societies.

A showcase of negative consequences of that manner on growth is the inefficient investment policies in the regions of Uzbekistan. Prior to reporting any investment needs to the upper levels of government, the local governors or *hokims*, who know the potential and the needs of their regions best, ascertain the wishes of these upper levels and rationalize their demands according to this information.<sup>8</sup> No additional first hand regional information which is essential for an efficient regional distribution of investments can be revealed by this mechanism. Consequently, even under tight budgetary constraints Uzbekistan is facing, there is over-investment in some regions and under-investment in others. As a result, the regional differences within the country keep growing.

#### **4.1.2 Respect towards traditions**

Traditions belong to informal institutions and can be described as internalized norms of behavior. Living in accordance with and obeying traditions constitutes formal social capital. Again, this asset may have positive as well as negative impacts on economic growth. Of course, not all traditions exert a relevant influence on economic growth, and the measurement of this influence is quite difficult. Thus the exercise to trace the influence of traditions on growth is of limited nature.

*At the macro level* of society, traditions determine practices of exchange, and they determine the degree and the attitude towards these practices. The AsiaBarometer surveys focus on the adherence to religion and on the attendance of religious ceremonies. Notwithstanding the atheist education of Soviet times, 69% of the 2003 respondents stated to be Muslim, with the majority of the population attending religious ceremonies and religious institutions on religious occasions. Only 10% of respondents

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<sup>8</sup> Center for Economic Research (2005), Tashkent.

said they never attend religious institutions. By 2005, their number has increased to 16.3%. However, taking into account the urban focus of the AsiaBarometer surveys, the importance of religion throughout the country can be assumed to be higher than revealed by these data.

The tradition of the religiously motivated *waqf*, the Islamic equivalent to a trust or a donation, is deeply rooted in the Uzbek society (McChesney, 1991). During the period between the twelfth and nineteenth centuries, the public *waqf* in Uzbekistan was the most important institution for the provision of social and public services to the community. In many aspects of daily life it almost completely substituted the provision of public services by administrative bodies. Hospitals, schools, public buildings and infrastructure including water infrastructure, social welfare to those in need – *waqf* was of central importance by that time. While the official *waqf* disappeared in the 1930s, donations and funds play a crucial role for the economy until today, although it is not always clear to what extent they are build upon *waqf*, and hence voluntary, and to what extent they are a sort of non-voluntary “*chaichona-nalog*” (teahouse-tax), i.e. unofficially requested contributions from wealthy people by administrative officials. The tradition of *hashar* – the mutual assistance on a voluntary basis normally not including monetary elements – is evident in many aspects of bilateral relations in Uzbekistan, and it facilitates collective action. At the macro level, *hashar* is called upon when contributions are needed for the funding of street cleaning and splendid festivities.

A vivid example of how traditions determine the attitude towards practices of exchange is the perception of corruption. The neutral or even affirmative attitude of the society towards corruption is deeply rooted in (Central) Asian traditions of exchange. In the 2003 AsiaBarometer survey, 21.6% of respondents stated they would bribe an official to obtain a refused government permit. However, nearly the same percentage (22%) said they would simply wait and see. In the perception of Uzbek businessmen as measured in the World Bank BEEPS surveys throughout different years, corruption is not perceived as a major obstacle in doing business contrary to their counterparts in other

transition countries.<sup>9</sup> Nonetheless, the Transparency International Corruption Perception Index, which relies on the opinions of mostly non-Uzbek businessmen and experts, graded Uzbekistan number 177 out of 183 ranked countries in 2011, with a substantial negative dynamic over the transition years.

*At the meso and micro level*, traditions have a vivid impact on the economic potential of individuals and households. In the AsiaBarometer surveys, the traditional roles of men and women can be observed in questions on marital status, family size and divorce rates: almost 80% of the 2003 survey respondents aged 30–39 were married with preference on early marriage, and only 6.7% within that age group were single. Family size is quite large, and the percentage of families consisting of three-generations living in the same household is at 22.9%. However, the divorce rate is relatively high with 10.6%. Parents' wishes for their children reflect traditionalism as well. While the top choice out of six possibilities for sons, as mentioned above, was “to become a respected man in the community” (39.9%, followed by “to be become a caring family man” with 34.4%), for daughters, it was the wish “to find a good life-partner” (75.9%, followed by “to become a caring mother of their families” with 42.6%). Reviewing the data collected in the 2005 survey, this traditional setting of lifestyle stayed nearly unchanged.

The direct economic impact of traditions on individuals is quite obvious in Uzbekistan, where, as in many other countries, obeying traditions is very costly for the family. Every important stage of a person's life is marked by costly festivities: being born (*beshik toi*), becoming a man (*sunnat toi*), getting married (*toi*), and finally four funeral events all marked by an *ertalabki osh* (morning pilau). The most costly event is marriage as it includes gifts for the involved families, furniture, dowries and, in most cases, in rural areas, a newly built house. Other traditions are also costly since up to several hundred people are to be invited to and fed at every festivity. In Soviet times, money income in urban areas was stable and high enough to pay for these events. In rural areas, income in kind resulting from private plots could guarantee the same. Since the beginning of the economic

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<sup>9</sup> For more detailed information see EBRD, BEEPS, different years.

transition, joblessness in the cities and run-down irrigation infrastructure in agriculture areas has been leading to a decrease in family incomes. At the same time, food prices have been driven up by inflation much more than other items of the consumer basket. Consequently, families have to borrow from their relatives and friends (there are no banks offering consumer credits). The impact of these festivities on overall economic growth is two-fold. Tradition-rooted demand accrues mostly in the informal sector of the economy and, except for dowries, does not boost official growth rates or state revenues. Secondly, the heavy financial burden traditions impose on the families diminishes the economic freedom of individuals, forces them to seek sources of income in addition their official workplace, lowers the efficiency at the official workplace, and drives corruption. These types of festivities are spread across Central Asia, and Uzbekistan is not the only country where families suffer from the economic consequences.<sup>10</sup>

A further economically important aspect of the traditional lifestyle is the unequal treatment of women which is deeply rooted in the Uzbek paternalistic Islamic society. It has serious long-term economic implications for Uzbekistan. As in any country with high gender inequality, the participation rates of women in the labor market tend to be low and fertility rates tend to be high. In Uzbekistan, the birth rate reached a peak in the 1980s with over 30 live births per thousand women. This is reflected in the demographic structure – according to the UNDP, in 2008, Uzbekistan had the “youngest” population in the Former Soviet Union (FSU) with 38% of the inhabitants below the age of 18. Although fertility rates declined since the 1980s due to the poor economic situation, high uncertainty and increased female labor force participation, the future mothers had already been born. Consequently, birth rates started growing in 2004 for the first time since the beginning of transition – the renewed (albeit illegal and hence not traceable in the data) tradi-

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<sup>10</sup> In 2007, the government of Tajikistan passed a law “On Streamlining Traditions, Celebrations, and Rituals in the Republic of Tajikistan”. This law regulates, for example, the amount of people allowed to attend various ceremonies and it forbids the celebration of state officials’ promotion or appointments to other jobs. During the first three months after implementation, the Tajikistan Executive Office reported an increase in private bank savings accounts by 7 USD million attributed to the new regulation. Umar Shavurov, 06-02-2008, *Wedding Regulations and Boosting Savings – World Bank Doing Business Blog*. <http://blog.doingbusiness.org/2008/02/wedding-regulat.html>, retrieved on 18.06.2008.

tion to marry girls off at a very young age exacerbates this phenomenon. The labor market in transition, burdened with post-privatization worker lay-offs in manufacturing, is not able to absorb this additional supply. The young people stay dependent on their families and their networks since social security for unemployment is minimal.

This new finance-driven immobility is endorsed by the third economically relevant aspect of tradition – the habit to stay in the home town with the family. Official data provide almost no information on this topic, but the fact that inner migration is quite low in Uzbekistan is widely accepted.<sup>11</sup> The reason for this traditional attachment to the land rests in the agrarian structure of the country, a fact that has not been very much affected by the socialist industrialization policy. The majority of the Uzbeks live in rural areas and earn income as farmers. Since land is an immobile factor of production, these people do not move away from their land plots. During the transition, the immobility of the rural population has perpetuated due to dependency on incomes in kind among the rural population, the lower education standards in rural primary schools, the *propiska* system in Tashkent<sup>12</sup>, and the dependency on the family social safety net. But even the urban and well educated population does not have strong incentives to move away from their native place. One of the reasons may be that leaving a community deprives the family and its members of one source of social capital – the networks they belong to. The limitation of national labor migration leads to sub-optimal results in the economy. The allocation of talent and labor within the country is inefficient and regional disparities in supply of skilled labor intensify. While geographic concentration in urban areas increases, problems with the poor urban infrastructure become obvious and cause environmental damages and health problems.

Concerning international migration, the motivation to move is much higher than for internal migration because the expected pay-off (in income or in knowledge) exceeds the losses resulting from leaving family and native-place networks. Migration to non-CIS coun-

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<sup>11</sup> Uzbekistan Living Standards Assessment, World Bank, May 2003.

tries is imposed with harsh restrictions by the Uzbek government. Uzbek nationals need to apply for an exit visa from their home country as well as for an entrance visa to third countries. This practice cuts international migration to the “far abroad” to a minimum. The small figures on non-CIS migration cannot be interpreted as a result of strong social capital ties keeping people at home, and the situation for CIS-countries differs substantially.

According to a 2005 report by the International Organization for Migration, Uzbekistan had approximately 16,000 officially registered labor migrants; for the same year, unofficial labor emigration was estimated between 600,000 and 700,000 persons (Mansoor and Quillin, 2007). Due to undocumented and circular migration, even these figures seem to be too low. The main receiving countries for Uzbek migrants are Russia, Kazakhstan and Ukraine. The export of workforce (although, as stated above, for the most part, illegal) is well organized and functions as a last resort for many families. The workers’ remittances are estimated to reach almost 20% of GDP in 2008, having increased from just over 5% of GDP in 2006 (IMF, 2009). In view of the eroding economic situation in the receiving countries after the financial crisis, working migration is most likely to have decreased substantially in 2010, but it is certainly going to resume with economic recovery of these countries.

#### **4.1.3 Generalized trust**

Both the 2003 and the 2005 AsiaBarometer surveys, as expected, reveal a very low level of generalized trust in the Uzbek society.<sup>13</sup> In 2003, only 19.2% of respondents say that “most people can be trusted”, whereas the majority, 80.8%, does not trust others and states that one cannot be too careful in dealing with others. In 2005, the situation improved only slightly, with 22% thinking that people can be trusted, and 77.6% preferring not to trust others. With this level of trust, is a “low-trust” country Uzbekistan compared

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<sup>12</sup> The so-called “propiska” system is inherited from Soviet times: only persons who can clearly demonstrate an objective need for settling in a certain town (new working place, study, marriage etc) are allowed to register officially; the system has been applied strictly in big cities with limited availability of living space.

<sup>13</sup> The possible answers in the AsiaBarometer survey with regard to trust are: high level of trust, normal level of trust, low level of trust, no trust at all and no idea. The level of partial trust and trust are frequent-

to OECD countries, and even compared to China. Compared to the transition countries described by Raiser (1999), who finds the average level of trust in transition countries to be at 23.2% of people who generally trust others, Uzbekistan is just a “normal” transition country.

A low level of generalized trust can be traced in other questions as well. In 2003, only 25.4% of respondents thought that people generally try to be helpful, whereas 74.6% were convinced that people mostly take care only of themselves. Following the same positive pattern as in the trust data, in 2005, the percentage of people perceiving a general attitude of being helpful rose to 29.8%, whereas supposed “individualism” fell to 67.9%. However, given the limited comparability of both data sets, this trend should not be overestimated.

Trust in institutions is addressed in a rather differentiated subset of questions of the AsiaBarometer. In 2003, most people partly distrust or completely distrust governmental institutions and the legislative system, the army being an exception to the rule with 65% of respondents trusting or partly trusting. The second governmental institution trusted or mostly trusted is the legal system (46.2%), followed by the police with 37% and NGOs with nearly the same level of trust ascribed. The changing role of labor unions is reflected in the highest level of distrust (40.2%) expressed by respondents. The public education system and the public health system are trusted only partly, as are local big business and international business.

Recalling once again the findings of Raiser (1999), who showed generalized trust to be irrelevant for growth in transition, but trust in institutions – especially in the police and the legal system – to be positively correlated with growth, the overall positive impact of trust on growth for Uzbekistan would be positive.

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ly taken as aggregate, whereas no trust is taken directly, ascribing to the relative percentage levels given. Interpretation has to be taken with caution.

## **4.2 Informal Social Capital: Interpersonal Trust and Economic Development**

The habit to rely on personal relations fosters the creation of personal networks in a broader sense (in China, this would be the well-examined phenomenon of “*guanxi*”). Building networks means accumulating informal social capital. With respect to networking capabilities, the Uzbek society can be divided into “Haves” (informal social capitalists) and “Have Nots”. The “Haves” can gain a lot by relying on their social capital: individuals will get help in case of misfortune, joblessness or old age, and they can gain access to other private goods that belong to their friends. Businessmen can reduce their transaction costs of doing business by relational contracting or by their membership in informal business groups. They may reduce their enforcement costs by acting under a “roof”. The state may gain from the existence of informal relations because networks substitute social transfers and information chains among officials are shorter. At the same time, the “Have Nots” are excluded from participation. This has various impacts on the different economic subjects.

### **4.2.1 Micro level: The nuclear and extended family**

Belonging to networks is an essential asset for individuals in Uzbekistan. The most effective and obliging network is the nuclear family, which usually consists of eight members (town: 6, village: 12), and the extended family. Three generations under one roof are no exception. Even in the urban-focused AsiaBarometer survey of 2003, almost 23% of respondents stated to live together with three or more generations in one household.

Close family ties work first of all as a social safety net, ease the pain of transition and lower the social cost of transition for the economy. The nuclear and extended family provide help in questions regarding school or university attainment (paying formal and informal fees for entrance and good marks), act as a helping hand in job-seeking (handling of information, crediting of possible entrance fees to the future earner of income) and often keep relatives working close to each other. Joint family earnings often replace the difficult to obtain credits by the banking system, when starting an individual

business. This way, families overcome the credit constraint and smooth the negative effects of the weak banking system in transition. Members of the family networks often become part of the individual's business networks. Once again, the role of interpersonal trust is the driving force behind this behavior.

The AsiaBarometer surveys highlight the importance of the role of the family by ranking the five most important of nine social institutions. In 2003, 98% of respondents chose "family" as the most important social institution, followed by relatives (74%) and place of work (53%). The results of the 2005 survey are quite similar (98.4% report the family to be the most important social institution, 80% the relatives, and 59.3% the workplace). Compared to other Central Asian Countries surveyed in the 2005 round, this reported preference is the highest in Uzbekistan, followed by Kyrgyzstan with 90.4% and Kazakhstan (85.3%).

The role of the immediate and extended family as a social safety net is captured by the question "what would the family do if the main breadwinner died or was unable to work?" The overwhelming majority stated that another adult family member would earn the needed money, 43% said that they would get support from their relatives. Only 11.6% would rely on social welfare payments, and 12.3% on retirement allowances.

The consequences of these aspects of family networking for economic development are twofold. On the one hand, competition in education and in the labor market is reduced, and the allocation of labor in the economy is distorted. Potentially highly qualified pupils may, and do, remain without appropriate education, and highly qualified workers may, and do, remain without appropriate jobs, which are occupied by people with lower qualification levels. On the other hand, the family helps to ease the social hardships of transition and partly fills the institutional vacuum left by the planned economy.

#### **4.2.2 Meso level: The Mahalla and other private networks**

The Uzbek *mahalla* is a special kind of residential community association that has a long tradition and is even fixed in the Uzbek constitution and in other legislative acts. In Uzbekistan, every person belongs to a certain *mahalla*, which may be a certain district of a

town, a village, some villages taken together or several family-dwellings taken together. The contemporary *mahalla* has on average 2000 residents, and over 10.000 *mahallas* are registered. A person automatically becomes a member of the *mahalla* into which he or she is born. The *mahalla* is led by a chairman (*rais*) and by a *mahalla* committee (*kengash*), and *aqsaqaly* play an important role in these institutions. The tasks of the *mahalla* are numerous and range from practical assistance to consultation and officially assigned public tasks. The *mahallas* provide their members with all supplies needed for the festivities mentioned above and organize the repairs to houses on the basis of *hashar*, offer consultations to families in case of abuse and divorce, organize neighborhood anti-crime-groups and waste collection and act as an authorized local level authority, providing certain forms of social assistance to those in need.

Since membership is not voluntary and *mahallas* are primary associations, a *mahalla* constitutes bonding social capital. The working mechanism behind *mahalla* activities was exclusively built upon vivid information, reputation and trust up to the mid-nineties. However, since the Uzbek politics began to transfer more state functions and duties to the *mahalla*, the “social system” *mahalla* turned into an “administrative system” *mahalla* (Sievers, 2002). Additionally, the international donor and financial organizations like the UNDP, the World Bank and the EU started to make use of the *mahalla* system for pursuing the establishment of NGOs, micro-credit programs or social assistance payments. By assigning such a variety of tasks to the *mahalla*, almost every aspect of former voluntary action and contribution has turned to a (legal) responsibility of the *mahalla*, its institutions and residents. This transformed the *mahalla* into a state agency reporting detailed information on individual persons to upper government levels.

In a survey of 2000 respondents in seven regions of Uzbekistan carried out in 1999, 57% of respondents classified the *mahalla* as essential to their daily lives. The regional differences are striking: in the capital, Tashkent, only 26% of the respondents relied heavily on *mahalla*, whereas in the more agrarian regions such as Khorezm and Ferghana, heavy reliance is shown by 86% and 89% of the respondents respectively. The more children a family has, the more it values the *mahalla*; the richer a family is, the less it

values the *mahalla*. However, the richest families either resent the *mahalla* completely or value it extremely high (Sievers, 2002). In a subsequent survey of 83 potential *mahalla* home buyers, Sievers (2002) found that individuals generally try to stay in the same *mahalla* and thus close to their relatives when searching for a new home.

In the more recent AsiaBarometer surveys mentioned above, the *mahalla* is considered to be among the most important institutions only by 38.8% of the respondents in 2003 and by 39.5% in 2005. The erosion of *mahallas'* importance since 2000 should not be overestimated: this could be due to the urban focus of the AsiaBarometer surveys, different structure of respondents and different design of the related questions. Notwithstanding the fact that the *mahalla* has been taking risk-spreading functions, similar to those of a family, a growing critical attitude towards the new "administrative system" *mahalla* might indeed play a negative role.

*Quasi-governmental private networks.* In addition to the Uzbekistan-specific *mahalla*, several successor-organizations of former Soviet governmental associations constituting social capital at the meso level exist throughout the country, similar to other transition countries. For example, the former *Zhensoviet* (Soviet Association of Women) was turned to the Women's Committee in 1991 and gained the status of an NGO. The *Komsomol* (Soviet Youth Associations) in 2001 was reorganized and became *Kamolot*. However, these and other quasi-governmental organizations do not seem to play a major role for the formation of social capital any longer. According to the AsiaBarometer survey of 2003, the importance of the social institutions such as labor unions, agricultural and commercial cooperatives and business groups as well as of clubs and hobby circles is rather limited. Merely 2–3.5% of the respondents assign each of these social institutions any importance at all. In view of this fact, the discussion of membership and qualification of these groups as Olsonian or Putnamesque seems to be obsolete in Uzbekistan. Kandiyoti (2007) concludes that these and other quasi-official networks do not seem to be vehicles for bottom-up collective action. They rather serve as an enforcement of top-down government directives and an efficient allocation of development aid.

*Market-substituting private networks.* Numerous exclusively private useful networks perform special tasks in the life of an individual. A medical network is useful in order to receive good and timely treatment without having to pay too many bribes. An infrastructure network is useful for receiving the needed amount and proper quality of irrigation water without having to pay too many bribes. A special case of networking in Uzbekistan is the *gap* (talk). *Gap* is a regular and, to a certain extent, formalized meeting of closely related friends (there are different *gaps* for men and for women). This *gap* is between the family ties and the useful networks, and it may perform functions of both of them. There is anecdotal evidence that especially women's *gaps* serve as informal rotating credit groups (Rasanayagam, 2002). Also in dealing with bureaucracy, networks play a decisive role in "getting things done". The AsiaBarometer survey of 2003 reveals that 37.4% of respondents would use "connections" to obtain a refused government permit, whereas a much lower share of respondents would bribe an official (21%).

At the same time, the reliance upon "connections" does not seem to constitute a desired public norm. When asked whether in an employment examination people would employ the person with the highest grade or the relative with the second highest grade, the absolute majority of respondents favored positions based on highest grades in 2003. It can thus be concluded that during the transition, the "connections" are overloaded with market-substituting functions, but at the same time people seem to feel uneasy with that "misuse" of personal relationships.

The implications of private networks for economic development are ambivalent. The networks are used to diminish bribes and to make them effective (the bribed person will in fact do the favor he has been bribed for), which has a positive effect on the economy. However, at the same time, the markets for these goods are distorted. The medical treatment is available for a well-connected individual rather than a person who most urgently needs it; water is delivered to the private plots of the well-connected individual and not to the farmer who needs it most (in other terms, to those who can give the highest potential payoff in case of delivery). This discrimination against outsiders hinders the proclaimed equal treatment (medical treatment is in principle free of charge) on the one

hand. On the other hand, it constitutes a severe obstacle to earnings in poor rural households and fosters impoverishment among the rural population. Both cases show how the development of efficient formal institutions is hindered by the existence of networks.

#### **4.2.3 Meso level: Open and closed business networks**

Businessmen who rely on personal relations and conduct their business even if state institutions such as chambers of commerce or courts are ineffective or lacking constitute a huge advantage for the Uzbek transitional economy with its, in many respects, still weakly developed market institutions.

*Overcoming the information gap.* The problem of “disorganization”, i.e. the problem of entrepreneurs to find suppliers and customers after the break-up of the formerly planned supplier-costumer chains has often been cited as the main cause of the transitional output fall (Blanchard and Kremer, 1997). This shortcoming can be avoided through business networks. Unfortunately, there is no empirical evidence on this type of informational advantage of relational contracting in Uzbekistan. As for access to agrarian machine-tractor-parks (MTP) owned collectively by several farmers, interviews reveal that a “good connections” with the MTP head grants that the farmer receives reliable machines at the time requested. If not, he has to buy the equipment himself (Trevisani, 2007, p. 91).

*Overcoming credit constraints.* The literature on finance in transition countries demonstrates that relational credit contracting based on reputation and trust can be a good solution when banks are underdeveloped and the financial market institutions are still missing. In the smaller farming sector relevant for countries like Uzbekistan, microfinance or lending based on the reputation mechanism are able to substitute professional financial services and may prove even more efficient, as they minimize the risk of adverse selection and the costs of credit monitoring.

*Social capital and labor supply.* In enterprise-level surveys like BEEPS, Uzbek businessmen state significant problems in hiring qualified staff. In transitional Uzbekistan, corruption in higher educational institutions is a universal phenomenon. Official diplomas and degrees offer no objective information. Reputation-based first-hand information on possible future employees is the most reliable source when selecting new staff.

*Social capital and state capture.* In sectors still working with state-controlled “production targets” (most enterprises in the agrarian and energy sector and many industrial branches), informal social capital can be used to betray upper-level officials and at the same time to promote business. Empirical evidence on the agrarian sector illustrates that collusion between officials at the lower statistical agencies who keep disaggregated farm data secret and the district agricultural department, which imposes production targets on individual farms, enables the latter to impose illegally high production targets to farmers who are less willing to make their “contributions” or do not belong to their networks (Trevisani, 2007, p. 90). In one case described by Trevisani (2007), such collusion made it possible to alter the cropping specialization of a farm and enabled the farm to survive (and made the district officer a man paid for his “service” with rice instead of cotton).

*Enterprises as Welfare Hotels?* Reliance on personal relations comes at the cost of being obliged to others. Those who are successful in doing business are confronted with their group (or family) members’ expectations of a job, money or other favors. The mere nature of these relationships implies that it is not always possible to decide upon these requests as an entrepreneur, rationally calculating a formerly acquired or expected payoff of this decision. In view of the former social character of the socialist enterprise, the risk of extensively being begged to do favors is very high for entrepreneurs in Uzbekistan. Anecdotal evidence shows that generally profitable enterprises were sometimes turned into mere “welfare hotels” and became unprofitable due to relational obligations. In unstructured interviews carried out in the district Yangibozor in 2003, wealthy farmers reported to be targeted with continuous requests for payments, contributions and “*chaychona nalog*” (unofficial so-called “tea-house tax” for renewal of public buildings, celebrations and donations) by district officials (Trevisani, 2007). Since these officials have an extensive potential to ease or to hinder business, the contributions made by the farmers do not bear an exclusively voluntary character.

*A hundred rubles or a hundred friends?* Given the fact that the qualification of the transactional content of favors done seems important, is it the relation to friends and family that is relevant for the transaction, or is it the money behind these transactions?

Insights into that are provided by the field research of Wegerich (2006), who conducted semi-structured interviews with 51 former and still employed farm managers from different districts. According to the 22 interviewed former farm managers, the decision on who will get the job of a farm manager is in fact taken by the district official (*hokim*) and not by the farm employees as envisaged by the law. All of these former managers declare that money is involved in the decision-making, 18 say that the price to be paid for getting the job varies according to the type of relationship with the *hokim* – friends and relatives pay less. 14 of these managers have been asked why they lost their position – 11 of them reported, that this was due to a new *hokim* taking over. However, unstructured information revealed that a manager may stay in duty even under a new *hokim* if he “pays and obeys” (Wegerich, 2006, p 118). Control groups in other provinces corroborate these results: not networks alone, but financial transactions influence the decision of getting a job. While “connections” may be useful for doing the job, they do not protect a poor reforming farm manager from losing his position again.

#### **4.2.4 Social capital at business level: Fostering or hindering economic development?**

At the enterprise level, social capital as a mean to overcome incomplete information on the markets of goods, finance and human capital is surely an asset for firms in transitional times. However, informal business relations and networks may create negative social capital and thus high entrance barriers for newcomers outside these networks who lack access to the information handled by them. As a consequence, competition is reduced, which counts heavily in an environment lacking competition since Soviet times. What is more, relying on relational contracting in business means limited geographic expansion and limited access to finance and technology. Such enterprises will hardly be able to survive once the economy is opened to international competition.

#### **4.2.5 Macro level: The state**

At the macroeconomic level, social capital reduces the availability of freely accessible information in all spheres of the economy. If markets are substituted by “getting things done”, information on who is financing what kind of transaction to what ends, via

whom and at what cost is not visible to outsiders and cannot be collected. This information deficit deprives the government of the possibility to identify problems clearly, and it makes it difficult, if not impossible, to develop efficient economic policy measures. At the same time, potential voters are deprived of the possibility to inform themselves of the performance of their rulers – a side-effect of poor information collection that might be desired as well.

The public budget in the social sphere can save substantial amounts by relying on informal social capital as a lender of last resort. However, social payments as such cannot be set at zero because there are people without or with financially weak networks, who need to be supported by state aid. The existence of networks, however, makes it quite difficult to target those in need efficiently. Payments out of the social system are based on information about the financial capabilities of a specific individual, and not on information about the capabilities of the networks the individual is in. The Uzbek answer to the problem mainly consisted in the delegation of the task of social targeting to the local level, namely to the *mahalla*.<sup>14</sup> But this delegation again runs into problems of personal relationship and dependence that lower its efficiency (and can easily be misused by *mahalla* officials for political purposes).

Even more than state finance, state governance itself is affected by informal social capital. The existence of networks within administrative bodies shapes the efficiency and the manner of decision-making exercised there. In addition to the reduction of informational procedures and transaction costs there is hardly anything positive to be found in informal networks within bureaucratic structures. The risk of misusing social capital in this field is extremely high, as the cost of the risk of doing favors in most cases will be transferred to the taxpayer. One of the problems arising from this risk asymmetry affects the efficiency of public investment. When informal social capital is misused by governmental officials in a clientelist manner, competition in public procurement is reduced and the risk of tunneling out of public investment to private needs

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<sup>14</sup> An evaluation of this kind of targeting based on household surveys in Ferghana valley is done by Coundouel and Marnie (1999).

grows. Financial assets will be spent inefficiently, and the development of private financial markets is hampered because of poor performing loans, bail-outs of non-performing credits by the state organs. “Connections” distort the labor market for governmental positions as well: if the expected payoff for investing in “connections” to get a good job in the governmental sphere is higher than the payoff for investing in educational efforts, the individual choice is quite clear.

A further concern for state governance and development outcomes is the high degree of personalization of official decision-making in Uzbekistan. The inclination to rely on personal relations makes it very difficult to separate the duty from the person who carries it out. The partner vis-à-vis an official runs into problems when his partner in the ministry is suddenly removed. The frequency of personnel shifts in governmental agencies worsens this problem in Uzbekistan. The phenomenon is well known not only to Uzbek businessmen but also to foreign investors doing business with Uzbekistan, including international financial donor organizations. The consequences for economic development are negative. The sustainability of doing business and implementing international programs is endangered by personnel changes. Accountability, a subcomponent of governance, suffers.

## **5 Conclusion**

With the limited number of data on social capital in Uzbekistan available, the questions put forward at the beginning of this paper can be answered as follows: yes, social capital helped and helps to ease transition on Uzbekistan in many aspects. For business, it works as a means of overcoming informational and credit constraints, for individuals as a social safety net and in general as a mechanism “to get things done”. But no, social capital in Uzbekistan does not promote the development of markets. It rather substitutes markets, as illustrated for the labor, health and credit market. Additionally, negative social capital enables collusion, reduces competition and imposes excess claims on the better-off thus sending wrong and not encouraging signals to business. And clearly no, social capital in Uzbekistan does not promote the development of efficient government structures. The privatization of governmental tasks undertaken by families, *mahallas*, and business does not create positive incentives for the state to cope with the situation. Together with negative social capital and clientelism, it rather enables the government to go on by muddling through. It seems to be highly important to reallocate social capital to the sphere it belongs to.

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