

# Patterns of Informal Trade in Petropavl, Kazakhstan

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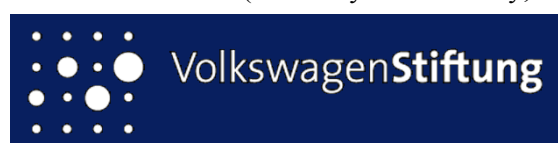
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## **Patterns of Informal Trade in Petropavl, Kazakhstan**

### **Introduction**

After the collapse of the USSR, the newly independent countries began a transition away from a centrally planned economy to a new reality based on the market economy. In Kazakhstan, as elsewhere, this period brought significant difficulties and uncertainties in the planned economy that led to the continued growth of the informal economy. Radical market reforms, the change of socio-economic development model, and the development of a free-market economy could not help prevent this type of economic activity. In turn, this illustrates that reforms implemented after independence created a new institutional environment that was inadequate to the functioning of business in a formal economy.

The informal economy in Central Asia has deep roots, but prospered particularly during the Soviet era, when the planned economy could not manage the demand for goods and services efficiently (Ledeneva 1998). A centrally planned economy is generally associated with communist and socialist governments such as the former Soviet Union and China. It is an economic model in which governments tightly control the supply of and demand for goods and services. Advocates of a centrally planned economy argue that this is a much more efficient way to make sure a country's resources are put to their best and highest use. Still, critics of centrally planned economies point out that ultimately, governments are unable to control market forces such as supply and demand. As a result, inefficiencies affecting both production and the allocation of goods result in shortages of commodities and other consumer goods because of ineffective production as well as the allocation of goods.

Thus, the enduring nature of the informal economy in Kazakhstan can be explained in light of its historical, cultural, and political heritage. Today, informal trade and its practices are a noteworthy subject for study because they constitute the largest part of the informal economy in Kazakhstan. Informal trade is estimated to make up 22.9 percent of the informal economy of Kazakhstan, while, for example, agriculture accounted for 15.6 percent, transport for 14.1 percent, and real estate for 12 percent in 2014 (Kazpravda 2014). Recent initiatives of the Majilis (the Parliament of Kazakhstan) further illustrate the prominence of the informal economy. In November 2016, precisely out of concern about the informal sector, the Senate adopted a law designed to bring the informal economy into the open through tax reforms.<sup>1</sup>

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<sup>1</sup> Act of the Republic of Kazakhstan on Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on Taxation and Customs Administration No. 26-VI of November 30, 2016 (Department of State Revenues, 2016).

This study is mainly interested in the puzzle of how traders circumvent state regulations. In other words, this study analyzes the informal trade practices of traders in the bazaar who are supposedly monitored by formal institutions. Scholars usually focus on bazaars in Almaty or Astana, or the larger bazaars of Kyrgyzstan that are supplied with goods from China. The informal trade networks in northern Kazakhstan have not been examined before now. I investigate the largest bazaar in northern Kazakhstan, Altyn Arman (formerly Kolkhoznyirynok), which is mostly supplied from the Russian Federation. More specifically, by observing informal practices in this bazaar, this study uncovers the dynamics through which informal trade adapts to formal regulations.

Consistent with the existing literature reviewed, it is assumed that two methods are available to traders to bypass regulations: (a) through personal networks based on trust and loyalty; and (b) through bribes without personal connections. In the former case, trust-based personal networks include kinship or families, close friends, friends of friends, acquaintances, and more distant relationships (informal cultural institutions). Hence, traders can circumvent state regulations *po blatu*, meaning through “right and necessary” people. In the latter case, traders can avoid personal connections and escape building further relationships by offering pecuniary advantage to certain interested parties.

However, this leaves unaddressed the question of what determines which method will be chosen in any given case. To address that gap, the following hypotheses are put forward:

(H1) the closer the degree of *blat*<sup>2</sup>—that is, the social proximity between individuals—the smaller the favor.

(H2) the greater the social distance between individuals, the larger the favor required, and the greater the resort to monetary bribes.

The two hypotheses stated above identify the social distance between persons as the key variable in understanding how they interact through informal practices. The social distance between people can be observed and examined through different situations depending on the problems that traders face in a bazaar.

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<sup>2</sup> In the Soviet Union, the word *blat* acquired a different meaning from the one it has in the criminal world (Ledeneva 1998). Those who experienced the difficulties of those times recall how they managed to do something or achieve something due to kinship ties or acquaintance with the “right” people. Thus, people have come to use the word *blat* to refer to informal relationships, contacts, families, friends, acquaintances, and also purchases on the black market. Under the permanent inefficiencies of the planned economy, the acquisition of goods often depended on acquaintance with the sellers or officials distributing a particular commodity. To denote such useful acquaintances and the process of purchasing goods in this way, people started to use the word *blat*.

This paper is structured as follows: the next section reviews the informal economy. Section two introduces the rationale for the study. Section three presents a detailed description of methodology. Sections five and six contain findings (shortened) and a conclusion.

## **Defining the Informal Economy**

Keith Hart (1973) first invented the term “informality” to describe economic activities occurring outside of established private- and public-sector frameworks among migrants in Southern Ghana’s urban areas. Such activities were believed to be an urban phenomenon. Yet now we can observe that informal economies occur not only in urban but also in rural areas within developing countries (Chen 2007; Hart 2005). In this context, it is important to distinguish between informal and illicit activities in the economic arena. For many years, researchers have struggled to find a consensus definition of the informal economy. Studies on Soviet and post-Soviet informal markets highlight an interrelation between informal and illicit activities (Sik and Wallace 1999; Bernabe 2002).

Studies on the informal economy in Latin America and Africa illustrate that informal activities can turn illegal and harmful (Dell’Anno 2008; United Nations Economic Commission for Africa 2010). However, while both informal and criminal activities are illegal in the strict sense of the word, a distinction must be established between the informal economy and outright criminal activities. Karrar argues that “[informal work] encompasses work that is basically licit but takes place outside the regulatory apparatus ... In other words, this is work that could have been done in the formal economy, unlike the criminal activities” (Karrar 2013: 461-462). For instance, while selling popcorn on the street is not illegal, if the seller does not have the proper license, then he/she is evading certain legal requirements (e.g. tax, safety, and health regulations) (Meagher 2013; Bacchetta et al. 2009). This means that informal activities are not necessarily criminal. However, the problem is that people usually generalize the idea of the informal economy by including outright criminal activities. Even though informal trade is outside legal constraints, the sector produces and exchanges totally legal commodities and services. It, therefore, should not be confused with criminal trade generating illegal goods and services (e.g., narcotics production or distribution, prostitution, money laundering, etc.). Instead, informal trade is viewed as a niche market that generates goods and services with lower prices for people. Yet traders do not follow the formalities established by the legal framework (Garcia-Bolivar 2006; Meagher 2013; Karrar 2013). For instance, anthropologists have conducted insightful studies of bazaars and marketplaces that function “with the support or the tacit approval of state organs” (Hardenberg and Fehlings 2016; Fehlings and Karrar 2016).

Some researchers state that the informal economy tends to prosper in countries with an unfair distribution of income. In other words, the informal economy is more likely to exist in less developed countries (Garcia-Bolivar 2006; ILO 2013). At an official level, different countries use different definitions of informality. For instance, the governments of Brazil and India refer to the informal economy as including only enterprises with fewer than five

employees (Rani 2008). In Indonesia, the informal economy is considered as only covering unpaid and self-employed family workers (Sugiyarto et al. 2006).

Others argue that informality should refer to behavior that is unpredictable, inconsistent, irregular, or invisible, as opposed to the predictable, conventional, regular, and normal behaviors found in the formal sector (Becker 2004; ILO 2013; Gerxhani 2004; Garcia-Bolivar 2006; Hardenberg and Fehlings 2016). Thus, something can be recognized as informal when it is outside the established formal patterns. For example, Bacchetta et al. define informal labor as “all remunerative work—both self-employment and wage employment—that is not registered, regulated or protected by existing legal or regulatory frameworks and non-remunerative work undertaken in an income-producing enterprise” (Bacchetta et al. 2009: 53). Furthermore, some researchers claim that informal labor is defined by the social security benefits and formal labor regulations that are not part of informal practices (Bacchetta et al. 2009; Chen 2010).

All enterprises, employees, and practices that function outside the formal regulations of the state, by that very fact, are located in the informal economy. The organizational forms used to manage the informal economy are considered informal institutions. Hence, informal markets are related to formal organizational forms to the extent that formal regulations are closely related to informal arrangements. Clearly, the lines between informal and formal economy are blurred (Garcia-Bolivar 2006; Becker 2004; VanderBerg 2014; ILO 2013), and indeed it is very difficult to separate the formal from the informal. The informal economy consists of largely legal activities and practices but with violations of some non-criminal laws such as the tax code, safety and health regulations, etc. In fact, the informal economy involves non-participation in at least three major areas regulated by the state: taxation, welfare and other social programs, and regulation (VanderBerg 2014). It is worth highlighting that there is also a concept of the paid informal economy, which is considered a subcategory of the informal economy. This concept is defined as “monetized exchange that is unregistered by or hidden from the state for tax, social security and/or labor law purposes but which is legal in all other respects” (Williams 2011, 25). Some scholars define the informal economy as a part of the economy the activities of which are not included in GDP (Garcia-Bolivar 2006; Meagher 2013).

In general, the informal economy includes the production of non-prohibited goods and services with no state control; informal institutions that are obedient to informal rules of behavior; and special interactions between economic subjects based on personal relations, contacts, and mutual trust. In this paper, informality is both a sociological and an empirical area of research. To put it differently, this study examines a category of human behavior. At the same time, it considers real economic actors, their conduct, and their connection to the community as a whole.

In light of these contributions, informal trade can be defined as *a sector of the economy, consisting of a set of informal activities of a non-criminal nature, regulated by their own informal institutions for the purpose of avoiding the costs imposed by state regulations, and consequently omitted from official calculations of economic performance.*

## **Rationale**

Informal social relationships within the formal economy have been studied by Lomnitz (1988). According to her, informal activities are not chaotic but rather support a steady system of exchange based on trust and loyalty among the participants, one which works in parallel to the formal rules of the state. This study also focuses on informal trade activities that are based on informal institutions such as trust, loyalty, and lobbying in contrast to formal institutions. Such informal institutions can be studied in the setting of bazaars.

In this context, the Altyn Arman bazaar is a useful research site to focus on for two reasons. First, it is the largest market in Petropavl, in the North Kazakhstan region. Most traders import their goods from Russia and sometimes Kyrgyzstan for distribution to local shops. This underscores the fact that Altyn Arman is the main hub for bargaining and trading processes in the North Kazakhstan region. Second, officially, payments in the bazaar are made in cash only, which opens a myriad of opportunities for informal practices.

To clarify, this study does not examine patronage politics, property rights, or power dynamics (Spector 2009), the historical development and gender dynamics of the informal economy (Werner 2004), or the size of the informal economy, poverty, or child labor (ILO 2013), as other studies do. Moreover, neither does it focus on illicit or criminal economic activities in the underground economy (the distinction between informal and criminal economy is elaborated above). Rather, I focus on the daily life of the traders who openly trade in the bazaar, yet circumvent certain state regulations, thereby engaging in informal economic activities. Thus, this study can shed light on the drivers of microeconomic processes, such as the decisions and behavior of individuals or individual businesses, in contrast to the aggregate expenditure and consumption of a nation, unemployment, inflation, or GDP issues in the overall economy. The findings of this study are relevant to the conditions found in other bazaars in Kazakhstan and other post-Soviet countries.

## **Methodology**

This study uses qualitative methods to answer a *how* type of question. It does so by collecting participants' real stories illustrating certain patterns of informal trade practices among traders in bazaars. The analytical challenge I address is to observe how informal traders bypass state regulations such as tax payment and bureaucratic burdens. Thus, the aim of the investigation is not to make causal inferences in response to a *why* type of question.

Data on informal activities of micro-businesses is limited, since researchers mostly focus on the macro-level dimension. National statistics mostly present estimates of informal activities by putting forward numbers without elaborating on the mechanisms employed in informal trade. This study, therefore, tries to focus on traders who respond to any changes in the market. Since the study is qualitative, it contributes to the discussion through interpretation, where knowledge comes from people who are a part of certain phenomena.

## **Data Collection**

This study relies on ethnographic case studies, formal and informal interviews, and the analysis of official documents. These methods complement one another in accordance with a triangulation strategy (Merriam and Tisdell 2015). When a researcher talks to participants and asks them questions, he/she is not watching or observing. Hence, only talking to participants makes the researcher more likely to miss some important patterns. In contrast, it is more useful to also observe people you question. In this way, the possibility of capturing as much information as possible is increased. In addition, review of legal documents helped me understand the rules and constraints that traders face and must comply with.

I spent about two or three days per week on this study during my three months of fieldwork in Petropavl. I conducted 18 in-depth semi-structured interviews with people of various professions, ages, genders, and ethnicities. The occupation of the participants in this study is important because it reveals the details of the phenomenon, in particular, the relationships between economic actors in the informal economy. The semi-structured interviews lasted for around 40 to 60 minutes and were based on open-ended questions. Even though the questions were prepared prior to the interview, some were asked spontaneously, flowing from the context of the discussion. In this way, semi-structured interviews allowed my respondents to raise issues that I had not considered before the interviews. The responses were recorded on an audio recorder with the participants' permission. I phrased the questions in a way that led respondents to give as detailed answers as possible instead of simple "yes" or "no" answers.

However, sometimes I talked to respondents in an informal way without any kind of record. This was very useful to capture additional information that could be reviewed later on, especially when the focus of the study was about informality.

Most respondents had no problems discussing and sharing information on the topic. They did not mumble about their informal activities related to bribes and personal connections. I assume that they consider such activities part of their everyday work. Of course, they realized that corruption was involved, no matter whether it was voluntary (bribery) or forced (extortion).

Paragraph-by-paragraph coding was used for the interviews in order to develop a descriptive analysis governed by the idea of what people experience. Since the interviews were audio-recorded, there was time to analyze the information successively. Transcription software was employed in order to proceed to paragraph-by-paragraph coding. Once all the interviews were transcribed, I could code each paragraph and identify common, repetitive, or emergent themes. Thus, I came up with particular patterns in informal trade activities, such as the resort to social networks, bribery, and the ability to negotiate.

Observation was used to observe traders' everyday life. To clarify, I observed how traders sold goods, negotiated with buyers, and interacted with other traders. In particular, this method helped me see when traders provided receipts and when they did not. In addition, I was able to see how the traders behaved when a customer asked for a receipt. This method allows a



researcher to get real first-hand insights into what traders do and how they perceive their job. My observations were recorded through the note-taking method. It is the simplest method of recording, but it allowed me to record everything I observed.

Finally, I studied the existing legal documents to establish the formal institutional framework. Specifically, the documents I reviewed were the Tax Code and Customs Code of Kazakhstan, the Kazakhstan Regulation of Commercial Activities Act, and the Commercial Code of Kazakhstan. They were used to understand all the rules and limitations that traders face and that can lead to informal trade activities. In addition, this helped to construct the interview questionnaire and identify which formal institutions might be replaced by informal ones.

This triangulation strategy was helpful to check the validity of information through different methods of data collection. For instance, it was possible to check information that was given in interviews through on-site observation or through documents related to the phenomenon. Furthermore, a triangulation strategy is helpful in supporting the internal validity of findings, since it is difficult to obtain an objective “truth.” For example, Maxwell (2013) argues that validity is “never something that can be proved or taken for granted on the basis of the methods used. Validity is also relative: It has to be assessed in relationship to the purposes and circumstances of the research, rather than being a context-independent property of methods or conclusions.” (p.121). Nevertheless, I agree that a triangulation strategy helped to improve the quality and decrease the bias of this study.

## **Sampling**

This study targeted three groups of respondents for a total of 18 individuals. The first group (7 respondents) consisted of traders working as individual entrepreneurs (*individual'nye predprinimateli*) in the Altyn Arman bazaar in Petropavl. This is the most important category in the study for the purpose of investigating informal trade activities. These people are principal economic actors in activities that are part of informal trade. I found one trader in the bazaar by employing personal relations and used the snowball technique of purposive sampling to obtain as many participants as possible. Talking to key informants directed me to people who provided further information. Indeed, I interviewed not only owners of certain businesses but also their subordinates (e.g. seller, accountant, middleman etc.).

The second group (9 respondents) consisted of state officials whose work interrelates with the activities of bazaar traders. People in this group are seen as agents of state power who supervise and regulate the traders' work within the framework of appropriate laws. Indeed, these inspectors are those who meet the traders halfway if there is a problem, thereby becoming involved in informal trade practices themselves.

To be more specific, this target group includes civil servants who work in state agencies and supervise the work of traders. I talked to three tax inspectors of the Department of State Revenues in the city of Petropavl. These people are authorized to monitor and ensure the

completeness and timeliness of tax income, customs, and other obligatory payments coming to the state's budget. Hence, they provided information regarding certain state regulations and rules that traders have to comply with. The employees working in the office provided me with information regarding various issues in local trade, including informal practices. In addition, I interviewed one prosecutor working in the Petropavl prosecutor's office regarding criminal issues in informal trade. Prosecutors monitor whether traders comply with the execution of appropriate laws applicable to the territory of Kazakhstan. The respondent provided me with information regarding problematic issues in regard to traders in the bazaar and in the city as a whole. I also talked to a fire inspector who inspects whether traders comply with the law in terms of preventing fires on their premises. He checks buildings, offices, industrial premises, shops, bazaars, and other facilities for their compliance with fire regulations and rules. He issues instructions with a list of any identified violations and their specific elimination deadlines. He can impose administrative penalties on violators by levying fines or can issue a warning letter. Another representative of a target population was an inspector for the sanitary and epidemiological service. He registers the record of the inspection, which is signed by an inspector and a trader. Traders are notified a month beforehand for a scheduled inspection and a day beforehand for an unscheduled inspection. If any inconsistencies are revealed, a protocol of offenses is drawn up in accordance with the Administrative Code, which protocol is later to be referred to the chief medical officer of the state sanitary service in the territory where the inspected object is located. If minor violations are found, then the businessman is assessed an administrative fine, and within three days, a statement of the basis for the fine is submitted to the court. Furthermore, I talked to three officials from the city's *akimat*.<sup>3</sup> Officials working in the *akimat* implement nationwide executive policy by monitoring the implementation of strategic plans and regional programs for social and economic development.

The third group of respondents consisted of two employees working in the National Chamber of Entrepreneurs "Atameken." The respondents provided information regarding problems that traders usually face, how they try to solve certain problems, and so on. The mission of the Chamber is to protect the rights and interests of businesses and to ensure broad inclusion and involvement of all entrepreneurs in the process of formulating legislative and other regulatory business rules. When a trader has a particular problem with any type of state regulations, he/she comes to the Chamber in order to consult with employees of the Chamber.

The sample size is relatively small, since I rely on qualitative research. Sampling in qualitative research is not built to be representative of a wider population as it is in quantitative research. Rather, it aims to capture diversity around a particular phenomenon. Data collection through observations and conversations is not focused on statistical findings but on the identification of representative events and people that can be analyzed in depth. In fact, each

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<sup>3</sup> The *akimat* is a regional executive-branch body that has many tasks, including coordinating the activities of law enforcement and other state agencies in the fight against crime and corruption and ensuring the rule of law.

group of respondents provided necessary information regarding informal trade activities by contributing various stories and views from different angles of the same phenomenon. Data analysis. The collection of evidence was organized around the two hypotheses put forward above. By relying on official documents and the personal stories of traders and officials, I identified four types of constraints (Table 1) traders face in their everyday activities. Indeed, these four constraints are interrelated with one another. These constraints are associated with different formal institutions that are replaced by informal institutions. These four categories create a foundation for testing the two hypotheses.

<b>Constraint</b>	<b>Formal Institution Involved</b>
Registration and permits	Bureaucratic agencies (various)
Contracts	Notarial service
Access to credit	Banking system
Tax burden	Department of State Revenue (tax system)

Table 1. Constraints and related formal institutions

First, I looked at bureaucratic issues that traders face: from opening new businesses through to their everyday activities. I asked them what kinds of bureaucratic difficulties they face when they open their businesses, submit reports to the bazaar administration, pay taxes and rent, obtain documents to take out loans, obtain licenses, etc.

Second, I looked at the impact of contracts, agreements between traders and other interest groups or individuals that are usually entered into through the notarial service. In this regard, an absence of formal contracts between parties will illustrate the importance of personal relations. For example, I asked traders whether they create a contract when they borrow money from other people, not banks. I focused on their alternative mechanisms of formal agreement that can ensure that a trader will repay the borrowed amount within a certain period of time. Certainly, the amount of money and, more importantly, the social distance between individuals will impact the process.

Third, I looked at the credit system, in particular, how traders borrow capital when they need it. I needed to ask traders what the alternative ways are to get the amount needed in order to open, maintain, or expand their businesses. In this case, I asked them who usually assists them if there is no way to take out a loan from the banks. It is important to know the significance of social distance when they borrow money. In other words, as a rule, when an individual takes out a loan from the bank, he/she must pay it back with interest. Informal practices can be different when, for example, your family or close friends will not charge interest.

Finally, I looked at how traders evade taxes by relying on *blat* and pecuniary exchange. Tax evasion is an illegal and deliberate avoidance of payment of taxes by individuals or legal entities. The methods of tax evasion by traders depend on the regime of taxation applicable to their businesses.<sup>4</sup> Generally, the main ways to evade tax payments are closely related to official reports of personal income and business profits. Hence, I needed to ask traders whether it is necessary to use personal relations in order to evade taxes, or whether they can avoid payment by using other channels. Moreover, I talked to tax inspectors who are directly involved in the process. I asked them how much traders usually pay in taxes, since inspectors check the declarations that traders fill in. The declarations indicate the amount of the traders' income, including the amount of taxes and pension contributions to be paid.

Traders are more likely to use either personal networks or monetary bribes in order to save time and nerves. How much they will spend on these informal trade practices will depend on their personal relations (*svyazi*) and impersonal methods (money). For instance, I investigated whether a relative in the tax department will help them for free, or another official will get money or another favor in return.

## Findings

Although informal trade practices previously existed, Kazakhstan is one of the post-communist countries in which informal trade practices have flourished after the introduction of the market economy. Traders in Petropavl use various informal channels in order to circumvent state regulations. Two major patterns can be highlighted with respect to informal trade practices in the city of Petropavl: personal networks and pecuniary exchange. For instance, a trader from the Altyn Arman bazaar, Saule, claimed:

Sometimes when I ask my close friends who can help me with certain problems of state regulations, I do not necessarily have to pay them something in return [...] but when I do not have such connections and rely on friends of my acquaintances, I definitely must pay a certain amount of money. I think it is just.

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<sup>4</sup> I derived two categories of tax payment regimes by relying on legal regulations such as the Tax Code of the RoFK as of January 2, 2017, the Commercial Code of the RoFK as of December 28, 2016, and the 2015-2017 Republican Budget Act of the RoFK as of November 30, 2015. All entrepreneurs must register with the tax agency prior to commencing their activities. Only after that process can they choose the taxation regime under which they will work. According to the Code of Entrepreneurs, there are three types of businesses in Kazakhstan: small, medium, and large. Each type is defined by the number of its employees and the amount of its average annual income. For example, small businesses must have no more than 100 employees and no more than 300,000 monthly calculated index (MCI) ( $300,000 * 2,121 \text{ MCI} = 636,300,000 \text{ KZT}$ ) of average annual income. Moreover, the small-business category has a subcategory for micro-entrepreneurs (traders) with no more than 15 employees and no more than 30,000 MCI of average annual income ( $30,000 * 2,121 \text{ MCI} = 63,630,000 \text{ KZT}$ ), established by the Republican Budget Act. The focus of my study is on this last category of traders, who actually can operate under two types of regimes: patent-based entrepreneurship and individual entrepreneurs with a simplified declaration, according to the Tax Code. Hence, each group makes different forms of tax payments for its activities. Indeed, the study shows that they use different strategies of circumventing state regulations based on the state restrictions.

Traders use these two methods to bypass state regulations, either through personal networks based on trust or through pecuniary exchange with or without personal connections. The goal of this paper is to explore what determines which method is chosen by traders under any given conditions. I created a framework that consists of four interrelated constraints and formal institutions that impose those constraints. This structure helped me to distinguish informal solutions that substitute for formal institutions. Traders rely on informal solutions such as kinship and bribery in the sphere of bureaucratic burdens; trust, reputation, and bribery in the sphere of the notarial service; bribery, trust, friendship, and informal loans in the sphere of the banking system; and kinship, “one-day” firms, fake pension contributions, and hidden profits in the sphere of the tax system. Table 2 summarizes each constraint discussed in the findings.

Constraint	Formal Institution Involved	Informal Solutions	
		<i>Blat</i> (H1)	Pecuniary (H2)
Registration and permits	Bureaucratic agencies (various)	Kinship	Bribery
Contracts	Notarial service	Trust, reputation	Bribery
Access to credit	Banking system	Trust, friendship, kinship, informal loans from wholesalers	Bribery
Tax burden	Department of State Revenue (tax system)	Fake pension contributions, decreased profits, kinship	“One-day” firms

Table 2. Mechanisms of interaction between formal and informal institutions

First, traders face various bureaucratic difficulties such as unnecessary and repetitive requirements when they open and maintain their businesses. In order to avoid such formal barriers they employ informal solutions such as *blat* and bribes, thereby overcoming those barriers. Traders employ *blat* through kinship relations when they need instant informal solutions like escaping a penalty for trading without a permit. The findings show that a trader can simply call his/her relative in order to solve the problem created by an official from the *akimat*. Since not every trader has personal connections to solve a certain problem, a trader without them starts to rely on pecuniary exchange. For instance, Zhanibek, a trader, claims that it is necessary to find common ground (*naiti obwij yazyk*) by bribing officials. In this case, bribery does not necessarily means money but other popular favors like horsemeat for the winter period. This mechanism shows that *blat*- and pecuniary-based informal solutions can replace formal institutions when needed. I argue that the acceptance of a bribe implies social inferiority, similar to accepting tips. Indeed, any material payment in return for a certain favor is considered graft (*vzyatnichestvo*). In most cases, this happens when there is no possibility of

relying on personal connections. It seems that cash payment or bribery is the last-resort option if one does not have the necessary personal relations.

Second, bribery, trust and reputation replace the formal institution of notarized contracts when traders try to negotiate with both officials and non-officials. These people can exchange favors (pecuniary and nonpecuniary) by relying only on trust and reputation. My analysis suggests that these are debts of honor among members of the informal sector that should be repaid at any time. Certainly, *blat* does have unwritten rules that include the ethical principle of exchange. For example, an individual who breaks such rules by not providing a particular favor in return can lose his ability (status) to employ such *blat* relationships in future. He becomes an untrustworthy person among members of the informal networks. In other words, in *blat* relations one should not cheat on others, and money does not play a role here. Instead, one should get involved in the problems of one's family or friends in order to show the ability to obtain or provide support. Breaking these unwritten rules has relevance to policy concerns such as aspects of tax revenues, criminal law (potential implications in health and labor safety), social welfare, and abuses by participants and public officials (blackmail, racketeering). When a trader cannot rely on *blat* relations, he tries to make a deal (contract) with a third party. In this case, a trader offers others an interest (*dolya/procenty*) in the form of money in order to solve problems. On the other hand, offering cash is not only an informal way to speed up a certain process but also a way to show gratitude quickly. In other words, there is no need to invest your time in building long-term friendships in order to use them in future. Hence, cash helps to pay back the debt at once. Another reason to avoid personal connections is not to be obliged to someone (return obligation) in future. It is better to use money in order to find mediators and solve a problem by yourself. Traders in bazaars often say, "I do not want to owe something to someone [in future] (*ne hochu byt' dolzhnym*)." However, money cannot always replace interpersonal interaction. For example, in view of the illegal character of graft, one cannot easily provide pecuniary exchange if there is a lack of trust and personal connections. Moreover, there are market rates (*taksa*) for particular services. This means that different factors such as the financial status of the "giver" and the level of personal relationships play a role here. The richer a trader is, the more expensively his request will be priced by people who can help. In this respect, the solvability of the problem also matters. If a person who wants to help assesses a situation as a difficult one, the price or favor sought in return will be correspondingly higher. In fact, this study shows that people use different strategies depending on their problems, purposes, and resources acquired within the sphere of informal trade practices.

Third, traders use informal solutions such as trust, friendship, and kinship, as well as informal loans from wholesalers and bribery, when they borrow money from banks or other parties. Contrary to Schatz's (2004) argument, the findings of this study suggest that there are still informal trade activities based on personal networks such as family, friends, and acquaintances. In this sense, trust creates solid social networks between economic actors, which eventually generate a community that can manage problems informally. Trust-based

interpersonal relationships are important for informal trade practices to function. Such relationships can serve as support for initiating, expanding, and maintaining business opportunities. For instance, traders rely on kinship and friendship when they have problems with the banking system. They borrow money from relatives, usually without any favors in return. Furthermore, traders can also rely on wholesalers who supply them with commodities by lending money without any interest charges. This investigation illustrates that traders in the Petropavl bazaar activate their personal connections for more effective and secure monetized exchange. Personal connections do not necessarily mean relatives, friends, and other long-term relationships. In contrast, there can also be short-term relationships based on practical goals. This means that such connections are employed during certain necessities only, for example, when a trader uses informal records of his monthly revenues as evidence of his profits when dealing with a bank. In this case, middlemen connect traders and bank workers, of course, where both middlemen and bank workers get their interest in the form of money.

Fourth, the tax burden promotes the creation of mechanisms of tax evasion, employing *blat* in connection with pension contributions and employing pecuniary exchange in connection with “one-day firms.” As part of their tax burden, traders have to pay a 10-percent mandatory pension contribution and an 8-percent income tax to the government. In order to retain as much profit as possible, traders, in particular patent holders and individual entrepreneurs, formally set their own and their employees’ salaries at minimum wage. They use loopholes in the legislation so that the tax inspectors cannot prove whether they are paying the correct amount of taxes or not. Traders simply do not include certain taxable income in their tax declarations, or they indicate expenses that they did not actually incur, which reduces the tax base. Moreover, there are cases in which traders use their businesses to help their relatives collect a certain amount of money for their future pensions without asking for any favors. At the same time, some traders earn extra money from people who need pension contributions but do not work for them in reality, as in Zhanibek’s case. In addition, in order to avoid tax payments, traders rely on transactions with “one-day firms.” These firms allow traders to abuse current legislation by evading taxes, converting profits to cash, or money laundering. Employment of such mechanisms involves pecuniary exchange between traders (usually between small and big businesses) for substantial amounts of money.

## **Conclusion**

Indeed, informal activities go along with formal institutions in maintaining the market. In other words, tacit state approval allows informal trade to function. Market-oriented reforms usually are not able to fully provide support to market institutions, but merely increase the costs for traders in dealing with formal regulations. Hence, as practice shows, people tend to provide informal favors in order to solve a certain problem. This is true of those who do not have personal connections to rely on as well as those who do have social networks. To put it differently, all groups of people tend to be engaged in informal economic activities if state

regulations seem costly to them. Unfortunately, although this labor activity bypasses the tax authorities and is contrary to the law, for traders in the bazaar it is usually the last opportunity to make a better living.

Moreover, this study shows that officials are ready to be engaged in informal trade activities in order to earn additional income. The main reason for this is the very low income of civil servants, who try to find another source of earnings somehow. Hence, it is predictable from the standpoint of civil servants that they will participate in informal economic activities. On the other hand, officials also take part in such activities due to feelings of duty toward relatives, friends, acquaintances, etc., to help if they are actually able to. As this study shows, they do not always ask for favors in return. As for traders, it is more about money—whether they are engaged in personal or impersonal practices. They usually offer a certain share of money to both officials and relatives who help them. Probably, they mostly focus on pecuniary exchange since business is their only source of income and they try to stay in business no matter the cost.

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