



# Informality and access to finance during socialism and transition – the case of the rotating savings and credit schemes

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## Abstract

Although access to finance has grown rapidly all over the world, largely based on the expansion of the banking sector, informal finance is still common. Rotating savings and credit schemes have been diffused in many countries across the world, including socialist countries, generally stimulated by a lack of access to loans. These schemes are informal (with no formal binding obligations or written rules) and voluntary, and their functioning depends on successful collective action. Although free-riding and other collective action problems would be expected, such cases have been rarely reported. Based on a set of in-depth interviews targeting individuals who were involved in such schemes in four different post-socialist countries, this paper shows an explanation to the question why free-riding was not the dominant strategy. The paper argues that the reputation and other social capital-components coupled with pressuring instruments used for enforcement of socialist ideology have been the key mechanisms that enabled the functioning of the rotating savings and credit schemes. The importance of trust and reputation received a high value in the selection of the schemes' coordinator, group members and size. These enabled the successful implementation of the rotating savings and credit schemes.

**Keywords** Informality · Rotating savings and credit schemes · Trust · Socialism

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## 1 Introduction

During the last three decades, both developed and transition economies have been subject to economic restructuring. Transition countries have witnessed growth in their financial sectors, largely based on the expansion of the banking sector, and of the economy in general. However, economic development has often been limited, in part due to conflicts between old and new emerging institutions (Tridico 2013). In many of these countries, the state's role and institutions were weakened and the state's ability to provide the necessary services diminished (Rose-Ackerman 1999).

Amongst the various functions that a modern state might carry out, support to its citizens to gather the financial means to fulfil their needs is fundamental. This is not necessarily a direct action of state institutions (such as subsidies or other benefits) but could translate into a legal framework to strengthen the banking and financial sector more generally. This would enable easier access to funds, provide a more stable environment where taking a loan is not seen as a (high) risk, or increase economic growth to widen the pool of people who have access to further funds.

Yet, in spite of this, access to formal finance is a major concern in many countries, giving rise to informal financing schemes elaborated and developed across the globe. There is a long tradition of such schemes that have been found in many cultures across developing countries such as Indonesia (Geertz 1962), Nigeria and Cameroon (Ardener 1964), Mexico (Kurtz 1973), China and India (Tsai 2004), and in developed countries such as Germany and Austria (Scholten 2000) and the United Kingdom (Cleary 1965; Casu and Gall 2016). They ascribe to a general need for financing mechanisms that operate informally, out of the reach of the state. In the literature, these schemes are largely known as rotating savings and credit associations (Ardener 1964). The key feature of these schemes is the voluntary participation of a small group of members pooling their contributions/savings to an interest-free common fund, which is then allocated in rotation to each participant.

Some of these schemes, especially in developed countries, have evolved from serving small groups to nationwide formal and well-structured financial institutions such as the ones in the UK, known as building societies. Building societies were 'mutual institutions' established in the late 18th and early 19th centuries where members would pool their savings to fund the purchase of land and construction of houses for all members (Casu and Gall 2016). Today, building societies also serve non-members and offer similar services that banks provide, including current accounts, or credit cards, even though their major focus is on financial products such as savings and mortgages. A key aspect of building societies is their community or regional-based orientation. Nevertheless, research suggests that many branches of building societies, especially in less affluent communities, are being closed, driven by adjustment strategies (French et al. 2008).

In China – still ruled by the Communist Party – there are a myriad of informal financial arrangements aimed at increasing access to finance to low-income entrepreneurs, from interpersonal lending, trade credit, moneylenders or loan sharks to rotating credit organizations and social organizations/mutual benefit funds, the functioning of which the Chinese government has tried to regulate or even ban (Tsai 2004). Tsai (2004) finds that, despite efforts from the Chinese authorities to channel crediting of low-income entrepreneurs through microcredit or other state-controlled instruments, many of the targeted groups continue to rely on informal finance.

Unlike microcredit schemes that are based on small loans with high interest rates, often with no collateral and that mostly target poor rural farmers with entrepreneurship potential (Yunus 1999), rotating savings and credit schemes apply no interest rates, the amount of contributions for each participant is the same for everyone and it has some flexibility in terms of turns of money withdrawal (Imami et al. 2018). Microcredit institutions such as the Grameen Bank give loans not only to individual applicants but also to groups of individuals (e.g. up to five members), whose repayment behavior is monitored closely by the staff of the microcredit institution (Yunus 1999), whereas in rotating savings and credit associations, the monitoring is performed by the group members themselves and the group size is decided on an ad-hoc basis and differs from group to group (Imami et al. 2018). Both schemes are somehow characterized by some form of group pressure to avoid defaults.

Given the spread and persistence of such informal financing schemes in different geographical settings and political environments, the questions that logically arise are: how such arrangements could be established outside the formal economy, especially in socialist countries with strict government control; how they are organized; and what kind of mechanisms are at play that keep them operating. In his work “Making Democracy Work”, Robert Putnam (1993) points out that, in spite of the fact that rotating savings and credit associations may violate the logic of collective action – the emergence of free-riders on contributions or defectors after receiving the contributions – such schemes have still flourished even in the absence of a Leviathan authority in many informal organizations around the world.

To shed light into the above question, we investigate rotating savings and credit schemes that operated in Albania and three former Soviet Republics, namely, Armenia, Kyrgyzstan and Uzbekistan, both during their socialist and post-socialist periods. These schemes are known as “llotaria/lotereya (lottery)” in Albania and Armenia and as “chyornaya kassa” in Kyrgyzstan and Uzbekistan<sup>1</sup>. They are informal financial arrangements that were widespread during the socialist period, and persisted, to a lesser extent, during the post-socialist period. Despite the differences in terminology, the organization and functioning mechanisms and principles are similar<sup>2</sup>.

We would expect that social capital components such as trust and reputation are the key instruments enabling the functioning of these informal savings and credit schemes. Since these schemes operate informally, the participants would rely on social instruments that would act as deterrents to free-riding or defection. We put some emphasis also on the mechanisms that socialist governments used to keep the citizens “in line” with the communist ideology and party directions.

The research work has been conducted in the four post-socialist countries. These countries are similar in various aspects. All these countries have been part of the eastern socialist bloc under the planned economy and entered the transition period in the early 1990s. However, Albania, differs from the others, as it was not part of the Soviet Union, although its economy, social and political life followed a similar pattern. The empirical material was collected through in-depth interviews and informal

<sup>1</sup> “Llotaria (Albanian) or Lotereya (Russian)” can be translated simply as lottery, reflecting the random assignment of the turn of money withdrawal, whereas “chyornaya kassa” can be literally translated (from Russian) as cashbox for black days, meaning cashbox for difficult times.

<sup>2</sup> In this paper, we use the terms “llotaria/lotereya or lottery” and “chyornaya kassa” interchangeably.

conversations. In total, 28 interviews were conducted, of which 13 interviews were with participants in rotating savings and credit schemes during the socialist period (SocPart), six interviews with participants during and after the fall of socialism (BothPart), three interviews with participants during transition (TransPart), and six interviews with interviewees who did not participate in such schemes but had knowledge about their functioning because family members or friends had participated in such schemes in the past (NonPart).

The paper is structured as follows. The following section consists of a theoretical discussion and literature review on informality and collective action. Section 3 provides insights into the organization of the rotating savings and credit schemes, while Section 4 analyzes its underlying enforcement mechanisms. Finally, the conclusions are summarized in Section 5.

## 2 Informality and collective action

Informal access to economic resources – often given to the incapacity of an overarching entity to act as a mediator between citizens, or citizens and (public or private) institutions – is an issue that has been debated for decades in the social and economic sciences. Debates on informality have since then widened in scope and geography. Research suggests that informality is, in fact, a globally enduring and resilient phenomenon (Morris and Polese 2014, 2015). It is arguably present everywhere. What changes across countries, and regions, are the spheres of life where informality is more present. However, ultimately, it cannot be fully liquidated as it is an integral part of state-citizen interactions and even state activity (Polese 2016). Further evidence of this, in fact, can be found in the recently published “Global Encyclopaedia of Informality” (Ledeneva 2018) where informal practices have been identified and described for a variety of cases across five continents (see also Imami et al. 2018; Polese 2018a, b).

The growing body of research on informality starting from Hart (1973) has continued to develop and has gone a long way from the narrow and quasi mono-disciplinary approach into a multi-disciplinary and comprehensive framework (Kaneff, 2002; Ledeneva 2013; Patico, 2002; Smith, and Stenning 2006; Polese et al. 2017). In recent years, authors have expanded the initial scope of research on informality to rediscover economic sociology approaches (Granovetter 1985) and argue about the coexistence of separate cultural and economic informality realms (Gudeman 2001; Yalcin-Hackman 2014). Such interpretations have opened a rich flow of informality research ranging from informal institutions (Helmke and Levitsky 2004; Isaacs 2011) to informality as a mode of governance (Ledeneva 1998, 2013; Misztal 2002; Polese et al. 2017). Indeed, in spite of its initial monetary focus, scholars dealing with informality have increasingly proposed a somehow post-monetary framework to the understanding of informality (Williams 2005) and the need to reconsider North-South relations, in an approach where both regions can be regarded as permeated by informal practices. Indeed, informal practices are conceived, perpetuated and exist among all segments of a society (Morris and Polese 2014).

Informality in post-socialism has been widely researched and theorized, emphasizing two different actors: the state and the citizen. Not incidentally, a significant theoretical and empirical contribution to informality debates has come from post-

socialist countries (see Giordano and Hayoz 2014; Henig and Makovicky 2016; Polese 2014; Morris and Polese 2014, 2015). However, this in no way means that informality is limited to the post-socialist region. Rather, other regions of the world could be the object of more accurate scrutiny since, as it has been suggested in a number of ways, “informality is here to stay” (Morris and Polese 2014:1). One perspective concentrates on the incentives, or lack thereof, for citizens to act according to official rules – this body of work often falls into the trap of assuming certain values to be universal and equally applicable everywhere. A sub-stream of this approach has explored the modes in which post-socialism could transform and align with more advanced or ‘effective’ states. The other perspective looks at practices and everyday ways of living in post-socialist transitions and the acceptance, or renegotiation, of the neoliberal economic and social model locally. Informality is, from this perspective, considered a way of creating survival strategies or, at best, domesticating neoliberalism through everyday practices (Stenning et al. 2010). These two perspectives have in common the emphasis on the mismatch between what the state “claims to offer to its citizens” and what it actually offers, or delivers.

In spite of a wide range of works on the post-socialist region, there has been a paucity of frameworks capable of explaining the persistence of informality in spite of attempts to formalize habits and institutions. In particular, the number and role of forces bringing disruption to rules conceived at the top political level during their application at the regional and local levels has not been sufficiently examined, just as its role has been largely underestimated. Political measures, or even just technical instructions, adopted at the national, or even regional level, may be ‘boycotted’ or even ‘sabotaged’ by middle actors, street-level bureaucrats or other state and non-state actors (Polese et al. 2019) guided by different paths or cultural norms. Scholars have explored the effects and consequences of rules conflicting with the local ethos, or simply norms (van Schendel and Abrahams 2005). Systematic ignorance of a given law makes the law to be de-facto non-existent and the conflict between a social and legal norm may eventually lead to a change in the law rather than the norm.

This goes in line with North’s argument that informal constraints are much more impervious to deliberate policies than formal rules, which can change overnight (North 1990, p. 6). North (1990) defines informal constraints as codes of conduct, norms and other social conventions, whereas laws, constitutions and other written rules are defined as formal institutions (North 1990, p. 4). Both formal institutions and informal constraints are not static, but evolve and change over time (ibid.). According to North (1990), institutional change is an incremental and a slow process, continually altering the choices available to us. The congruence between choices individuals make and the institutional constraints depend, however, on the effectiveness of enforcement, which is carried out by self-imposed codes of conduct, retaliation by second party, and/or societal sanctions or coercive enforcement by the state (North 1990, p. 4). The effectiveness of enforcement is particularly important to understand why cooperation between individuals takes or does not take place. As pointed out in North (1990), cooperative behavior is more likely to be observed in settings where individuals have information about each other when they repeatedly and frequently interact with one another (see also Axelrod 1984, Hardin 1982).

Nevertheless, even self-organization can be threatened by the underlying intrinsic dynamics of the group and might not be able to deliver for their members, especially

when the group fails to generate key composites of social capital, such as trust. Granovetter (1985) argues that the generation of trust in economic life is a product of social relations rather than institutional arrangements or generalized morality (p. 491). Social capital itself consists of two elements: it is an aspect of the social structure and it facilitates certain actions of the actors within the social structure. Social structure is the resource, real or potential, gained from relationships. These relationships, in turn, facilitate the action of individual actors (Coleman 1990). Meanwhile, for Lin et al. (2001), social capital can appear in a number of forms: trustworthiness of the social environment – which means the obligations to be honored and it can also reinforce an individual's identity and recognition, enhancing actors' 'social credentials' as a source of information in social relations, providing individuals with low-cost information about the opportunities and choices otherwise not available, which can also help individuals in more efficient decision-making, and as norms and effective sanctions that lower monitoring and sanctioning costs.

Citizens are able to organize informally themselves in nested multi-layered institutional arrangements and maintain positive collective outcomes (Ostrom 2005). Game theory models and numerous case studies have provided important insights into the sustainability of cooperation among rational self-interested actors. While game theory models focus on the strategic interaction of self-interested actors, considering the cost-benefit incentives that guide their (non) cooperative strategies, case studies provide deeper understanding, considering the institutional and socio-economic attributes that shape the settings where the interactions take place. Inequalities in wealth, trust, leadership and group size are some of the common variables identified as being important for collective action (Ostrom 1990; Olson 1965). In his seminal work, Olson (1965) argued that in groups with unequal endowments and interests, a dominant actor who enjoys enough benefits compared to his costs from the provision of the collective good, will continue to contribute although he would have to incur large parts of the costs. However, the way benefits are perceived and discounted depends also on the number of actors. For example, Olson (1965, p. 2) argued that “unless the number of individuals in a group is quite small, rational, self-interested individuals will not act to achieve their common or group interests”. Ostrom (1990) goes in the same direction, arguing that if only a few actors need to cooperate in order to produce sufficient collective benefits, then the number of actors in the cooperative arrangement should be small. On the other hand, there are cases when a large number of actors can provide public goods more efficiently than smaller ones (Isaac et al. 1994). The key idea is that the optimal number of actors must be consistent with the amount of individual and community benefits and costs expected from the collective action (Ostrom 1990). The size of the group, though, reveals only one part of the social construct of a community.

Social capital is another component of the social structure of a community (Coleman 1990). Problems of cooperation and local organization characterized by low levels of trust are widespread in former Eastern Bloc countries (Rose-Ackerman 1999). They are inherited from the past communist legacy, where the forcing of people into “voluntary” work made people felt being exploited by the socialist regime (de Waal 2005). Trust is an important element of social capital. It can be a powerful means of reducing transaction costs of reaching an agreement, enforcing and monitoring the agreed-upon rules. Williamson (1985) suggests that, although everybody prefers provision of

the common good to lack of it, lack of trust precludes the incentives to contribute to its provision, since everybody fears that others will defect and not contribute.

We start from the suggestion that the above-mentioned interpretative framework is sufficient to provide an interpretation of the rotating savings and credit schemes that have emerged in the countries under investigation. Subsequently, we show how the informal arrangements and other social constraints employed by the participants, such as norms, trust and reputation, facilitate the functioning of these schemes and sustain collective action.

### 3 The functioning of informal rotating savings and credit schemes

In the absence of private banks, restrictions on loans by state-run banks and low-interest rates on savings, informal rotating savings and credit schemes became an important and useful instrument to get access to financial services for meeting different household needs during socialism. They were commonly organized in working places such as factories, schools, public administration and other public service units, and in some cases also in neighborhoods among neighbors of the same or close-by apartment buildings.

The advantage of rotating credit schemes is that they do not apply an interest rate and there is no collateral or bureaucracy and paperwork required as from formal financial institutions. These schemes were exclusively informal (with no formal binding obligation or written rule) and voluntary. As one interviewee explained, although the de-facto organization of such schemes was allowed to exist, and although the higher officials were aware of their existence, they were not supposed to talk openly about it to the party officials. One SocPart interviewee stated: “Officially it [rotating credit scheme] did not exist, and since it did not exist, you could not forbid it”. While one NonPart stated that even party officials were often involved in such schemes.

As explained earlier, in Albania and Armenia, these schemes were called “llotaria/ lotereya” (lottery). The lottery-nature of these schemes relates to the allocation of turns for withdrawing the common fund by each of the participants. Practically, it is organized in the following way: before the lottery is drawn, the participants would have to determine and agree on the amount of contributions they would have to pool in the common fund each round and the frequency of contributions and of receiving the money. The amount of contributions, as will be explained below, usually depends on a combination of factors such as the level of salaries, the number of participants and the financial needs that are expected to be met through the participation. Meanwhile, the frequency is generally related to the frequency of receiving the salaries. For example, during the socialist Albania period, employees received the salaries twice a-month, whereas during the transition period (also presently), the salaries in the public sector and in most private enterprises are distributed on a monthly basis. After reaching an agreement on these issues, the participants then appoint a coordinator who is a member of the scheme (often he is the initiator of the scheme).

The coordinator would be in charge of facilitating the collection and distribution of the contributions, as well as for preparing the lottery. For drawing the lottery, the coordinator prepares a number of papers that are serially numbered from one to the number corresponding to the total number of participants and folds them so that the

numbers could not be seen by the participants. Afterward, the coordinator invites the participants to draw one of the folded letters, which determines the order in which each of the participants will receive the money. Often it happens that one of the participants may need money at a certain moment because of unexpected events, but his turn might not correspond with the turn determined by the draw. In these cases, the participants negotiate and could swap their turns so that he meets his financial needs. In other cases, participants negotiate in advance the preferred time period when they may withdraw the money – the order of withdrawal is mostly or entirely based on the members' financial needs from the very beginning, without applying the lottery principle. While, due to financial needs, some might have an urgency to take the first instalment, others might prefer to be the last. As one SocPart stated: "some preferred to be the last, because, taking your share/instalment from the beginning meant feeling indebted until the end of the cycle".

Generally, the money received from these schemes was used for purchasing different home appliances such as TV-sets, refrigerators, washing machines, or furniture, depending on the needs of the family. A TV-set in Albania would cost about seven monthly salaries of a teacher, a refrigerator about nine monthly salaries, whereas a washing machine was about five monthly salaries. The costs of the items to be purchased or family needs played an important role in determining the amount of contributions and the number of participants. One SocPart interviewee stated that "I became part of the "Ilotaria" to furnish my house. I had just got married. We started everything from scratch, from forks and spoons to washing machine and TV set".

There are also reported cases where these schemes have been used for financing farming or small business activities. One BothPart interviewee from Kyrgyzstan mentioned that it is common for farmers to buy cows through rotating savings and credit groups, while another interviewee (NonPart) from Uzbekistan mentioned that rotating savings and credit groups can be used for funding small business activities such as buying a car to be used as a taxi.

People also use the rotating savings and credit group mechanism for social events, such as weddings, funerals, and/or birthdays. One NonPart interviewee from Kyrgyzstan (whose mother had been participating in many rotation credit schemes) stated:

"The quality of social events, such as weddings or funerals, is related to the reputation in Kyrgyzstan, therefore, there is growing pressure for people to spend a lot of money for such social events, to keep up their reputation. And "chyornaya kassa" is a commonly used funding mechanism for such events among households in Kyrgyzstan."

The number of participants taking part in a scheme varied. In-depth interviews showed that the number of participants in the investigated rotating savings and credit schemes usually ranged from six to 20 people. The size of the group also determined the duration of the rotating credit scheme cycle and the frequency of money distribution. For instance, rotating credit schemes with six people could last six months; with eight people, eight months and so on. However, the duration and frequency of money distribution could be determined and agreed on a scheme-basis. One respondent (BothPart) who has participated in eight schemes during and after socialism in Albania explains the differences in group size and frequencies in money distribution as follows:



“The largest group I have participated in comprised 20 members, whereas the smallest group comprised 5–6 members. The average group comprised 10 members. The small group was preferable because it finished quicker. The duration of the “Ilotaria” was usually 6 months to 1 year, but not longer, because people became tired. In most cases, the money would be collected every 15 days, given that the salaries were received in two (monthly) instalments”.

However, there have been cases when, at one working place, more than one group was formed. An interviewee (SocPart) from Albania who was a director of a secondary school during the socialist period, pointed out that, at his school, there were various “Ilotaria” groups operating at the same time (by teachers). Another interviewee, who also participated in “Ilotaria” organized among teachers during the transition period, pointed out that they had set up two groups of around 10 participants in two different schools and some participated in both groups. Similarly, there have been also cases from Kyrgyzstan when one participant has taken part in more than one group at the same time and for a long period. A NonPart interviewee describes it the following way:

“My mother has been participating in up to 5 different women groups simultaneously, when she was still living in the village. One group was of former colleagues, another of neighbours - she continued participation in the group of former colleagues of “chyornaya kassa” for 25 years, until she left the village. The monthly contribution in each group could be 15–50 Euro/month. My mother could put into all the “chyornaya kassa” that she participated in up to half of her income. She would always get her turn before summer because her main intention was to use that for vacations - that had been agreed with other group members.”

A distinguished specificity of these schemes that made them attractive to many employees relates to the flexibility of who could be in and out of the scheme. On the one hand, a participant who needed to save and mobilize enough financial resources to cover different household needs could withdraw two numbers, i.e. he was counted for two people. In such cases, the time of receiving the money could have a more predefined rule – for example, the person would then receive the money once at the very beginning and once at the end of the cycle. In this way, the risk of the person dropping out in the middle of the cycle would be minimized. In other instances, group members could also invite close relatives to be part of the scheme, although they might not be working at the same place. In these cases, these persons would serve as guarantors for their relatives. On the other hand, participants could also quit the scheme especially in the early rounds for as long as they have not received any contribution (although that was rarely reported). In these cases, the person who quits the scheme would just get back his share of contributions. The other participants may replace him with another or simply continue the cycle with one person less.

Another important characteristic that makes these schemes differ from one another relates to the amount of contributions. They were determined before the start of the cycle on an ad-hoc basis and depended largely on the salary of the participants and the overall economic conditions of the household, i.e. whether they had enough resources to cover the monthly needs of the household. However, the amount of contribution was

unique within a single group, but it could differ between different groups. Usually, the amount of contribution would be 10–25 per cent of the monthly income, although it could be even higher. For example, in one case, one member contributed to the rotating credit scheme up to 50 per cent of the salary, justifying it with the fact that her household needs would be covered by the salary of her spouse. One reason why these schemes were more diffused during the socialist time was the fact that salaries were more homogenous, with smaller, if any, differences within a single institution. However, in working places where the salaries were usually very low, such schemes were not so common. For example, for people who were employed in agricultural cooperatives in Albania, salaries were so low that significant saving was not possible, so these schemes were less common or operated with far smaller contributions, while during the transition these differences are often high. It also appears that such schemes were more likely to develop in sectors where salaries were high enough to be able to save something but low enough not to meet the needs. One TransPart from Armenia stated: “when I worked as a teacher during 2006–2016, the “lotereya” was much diffused among teachers at our school, and I participated several times, but when I moved to better-paying jobs, I did not witness any case of “lotereya””.

Also within the same social group, people showed different behaviors and not all participated in such schemes. For example, one respondent (NonPart) mentioned that she was offered to participate during socialism but she did not accept because “[I] was capable to save, so did not need to participate in “llotaria” to discipline [myself] to save”. In contrast, one SocPart mentioned: “Participating in “llotaria” was a self-disciplining strategy to save... I could not save otherwise”.

Although the principles of operation are similar among the different countries, it appears that, in the case of Uzbekistan and Kyrgyzstan, such schemes have an additional social function – they serve as important platforms for networking and social inclusion. One NonPart interviewee from Uzbekistan highlighted that even people who are well-off participate in rotating savings and credit groups, simply for networking reasons, which is often the (only) key to participate in some informal groups. A Kyrgyz lady who participated in five groups simultaneously did not just contribute to the “chyornaya kassa” for financial reasons. As this NonPart interviewee from Kyrgyzstan emphasised:

“One important reason why my mother was part of 5 different groups was to be part of 5 informal networks. The meetings that are organized regularly (e.g. once a month) in a bar/restaurant or in the house of one of the group members serve not only to discuss different issues about the “chyornaya kassa”, but also as a social event where they exchange information concerning the community.”

Another NonPart interviewee from Kyrgyzstan emphasizes further the important social role that participation in the “chyornaya kassa” have for some communities:

“My father in law was doing well economically during the Soviet Union, and he could be part of several groups that ran “chyornaya kassa”, which gave him access to these informal networks. After the collapse of the Soviet Union, he could not participate anymore in these groups, due to financial limitations (he was unable to contribute). As a result, he was gradually excluded from the informal

networks associated to the respective “chyornaya kassa” groups – he was not invited, for example, to parties or social events.”

The flexibility of these informal schemes and the lack of other attractive formal sources of finance to meet various financial needs, as well as the opportunity to participate in informal networks, provide reasonable incentives for encouraging the establishment of these informal financing schemes. However, a question that remains is what kind of mechanisms were at play that made these schemes functional? Some tentative answers to the question that sparked our curiosity and made us embark in this research are provided in the next section.

#### 4 Enforcement mechanisms in informal rotating savings and credit schemes

As mentioned earlier, Putnam (1993) rightfully points out that in spite of the fact that rotating credit associations violate the logic of collective action, that is, the emergence of free-riders on contributions or defectors after receiving the contributions, such schemes have still flourished even in the absence of state authority (p. 168). In many of these settings, components of social capital including reputation, trust and density networks of reciprocal engagement are considered as key mechanisms that avoid the risk that most of these schemes default (*ibid.*).

Similarly, these aspects have been key also to the socialist-time rotating savings and credit schemes, albeit with some differences in sanctioning mechanisms. While in many rotating savings and credit associations social capital (reputation, trust, norms, and density networks) determines the choice and effectiveness of sanctioning mechanisms, these elements of social capital were complemented with socialist-oriented political ideological impositions. Building the “new socialist man” was the dominating slogan of the socialist area. Efforts to indoctrinate and enforce this ideology ranged from schools to working places, largely relying on peer pressure. One of the common instruments that the socialist regime used as a deterrence tool to any behavior that would deviate from the ideology of the “socialist man” was the use of public discrediting via means of caricatures or other visual and narrative representations that were published in designated boards, set in every workplace or school. Therefore, avoiding ending up in one of these boards provided incentives even for “Ilotaria” participants to ensure their compliance.

An illustration of available sanctioning mechanisms at the disposal of the participants is provided below from a SocPart interviewee from Albania:

“There have been no problems because we knew one another, and therefore we had no disagreements. In case problems with payments of contributions would be faced, the coordinator of the “Ilotaria” would notify the finance person to keep the amount from the salary<sup>3</sup>. This was only one of the sanctioning mechanisms,

<sup>3</sup> It was common that accountants who were responsible for distributing the salaries were involved in “Ilotaria” schemes, when they were organized in working places. However, it has to be noted that they had no formal/legal right to keep the salary from anyone who would opt out and not pay his obligation, despite this perception stated by the interviewee.

because in such cases [not honoring the obligations], the individual who would breach any agreement would be very vulnerable to end-up in FLETE-RRUFE<sup>4</sup> published in the so-called emulation boards that each public working place had; hence no such cases [default] occurred”.

Interviewed participants stated that there was never the need to impose such mechanisms because “we were colleagues”, “close friends”, or “we knew each other very well”. Being closely socially connected does not, nevertheless, imply that no risk of free-riding or default exists. Participants were carefully selected based on trust and the reputation, and, even in cases when an outsider (for instance, a brother or sister of a work colleague) was admitted in the scheme, the trust in and reputation of the work colleague would serve as a guarantee. The trust and reputation of group members were so important and binding that even in cases of any unexpected events (such as sickness), members were very concerned about honoring the obligation. Thus, the participants’ contribution obligation was strong and binding, reaching the whole family. If someone defaulted, there was a common understanding that the debtors would knock on the doors of the family or relatives to get back the debt. One SocPart Albanian interviewee highlights how important and socially-binding it was to honor her obligation with her experience and views as follow:

“I participated in several “Ilotaria”, and in one of them, I participated to finance the wedding of my daughter, which was organized by a close friend. Normally, the procedure was to draw the (lottery) numbers to determine the rounds (turns), but in this case, they decided to allocate the first round to me, so that I could finance the wedding. It happened that I got very sick (hospitalized) after receiving the installment, and I was very worried that in case I would die then my newly-wed daughter would have had to pay back. .... there has never been a case that a participant did not pay, even if they had financial difficulties”.

There was reported only one case of a default, namely, the case of a participant who did not continue to contribute. One BothPart interviewee stated that the person:

“... was socially-excluded and socially-isolated... he lost the respect, face and trust... no one wanted to deal with him and he was not invited anymore to social events that took place in the community... people may understand that you may have an excuse or problem which causes you to default, but still, that does not help, you will be excluded from the community”

The importance of trust and reputation received a higher value especially in the selection of the coordinator. This is highlighted in several in-depth interviews and informal conversations. For instance, one SocPart interviewee states: “the person who

<sup>4</sup> Fletë-Rrufë was a caricature-style representation of an [anonymous] individual’s behavior that did not fit to the socialist values proclaimed and promoted by the socialist government in Albania. It is not directly related to the “Ilotaria”, since it was considered informal, but participants would “save” this action to use it, whenever the opportunity arose.

coordinated “lhotaria” was one of the participants and a trustworthy, mature and careful person”.

This logical, yet pragmatic, selection of group members and coordinators has contributed to avoiding default of the schemes and enforcement of sanctioning mechanisms that would have had repercussions in social relations between group members. Residential mobility and changing of workplaces during socialism were highly restricted and exclusively imposed by the communist party apparatus. Hence, exit options for group members were very limited, making rule conformation easier to implement.

This is reflected in the lower organization of such schemes during the transition period. From in-depth interviews and informal conversations with participants and non-participants, high mobility of people, income inequality, job insecurity and increased levels of distrust have been considered the main reasons for the reluctance to organize such schemes during the transition. The majority of factories and other public entities that used to employ large numbers of workers closed down after the collapse of the socialist regime. That was followed by significant internal migration flows, especially from former remote industrial towns (but not only) to the largest cities or from rural to urban areas. Furthermore, several post-socialist countries, most notably Albania and Armenia, experienced mass emigration. Thus, the existing social networks that enabled the functioning of these types of financing schemes weakened. Also, finding permanent or long-term employment in new working places that could serve as a basis for building trust through long-term continuous social interactions became harder. Similarly, the socialist-style sanctioning mechanism that targeted the social/peer pressure and reputation of individuals could no longer be effective. As a consequence, the risk of free-riding and default increased.

Regardless of these unfavorable conditions, the changes in the overall political and economic environment that accompanied the transition from socialism to capitalism remained and created new opportunities for the organization of these schemes. For instance, in the case of rural communities in Kyrgyzstan and Uzbekistan, strong informal networks continued to persist, due to higher social cohesion. As one BothPart interviewee stated, in Kyrgyzstan, it is common that one single clan (extended family) makes up for a large part of a single village, and it is within the extended family that often the savings and credit rotating schemes are organized. That might explain why such informal credit schemes are still highly diffused in these two countries. The failures in the financial sector during the early transition, in addition to very high-interest rates on loans, necessitated the need to rely again on informal financing schemes. Indeed, one interviewee from Armenia highlighted that the failure of some private banks during 1992–1994 made the people lose trust in the banks and still rely on “lotereya”. This was similar also in the case of Albania, which experienced the failure of the notorious pyramid schemes that led to the social unrest in 1997.

Nowadays, the organization of rotating savings and credit schemes is established along close friends-or relatives-lines, long term neighbors or colleagues who worked together for a long time, with smaller groups. These group characteristics, friendship or kinship-based and often small size, are preferred for two simple reasons. First, the cycle is completed fast, for example, within five to six months depending on the number of participants. And second, since no credible and low-cost enforceable sanctioning mechanisms are available, trust is the key mechanism that could make possible the functioning of the scheme. As one respondent (NonPart), whose mother was an active

participant of “Ilotaria” stressed, he would not participate in such schemes because he could not trust his money to anyone else, be it an individual or even a bank.

As collective action theory suggests, collective action is more likely to emerge and be sustained over time in groups of small size and with high levels of trust (Olson 1965). All these elements combined can be considered as the determining mechanisms and instruments that affect successful implementation of these types of rotating savings and credit schemes. Trust was central to the functioning of the scheme. Accordingly, the lack of trust could be one thing contributing to its decline or simply preventing people from participating. With low levels of trust, neither formal nor informal institutions can function. Thus trust, combined with availability of leadership and proper group size can be considered as the determining mechanisms and instruments that affect successful implementation of these types of rotating savings and credit schemes.

## 5 Conclusions

This study showed that access to finance does not occur and need not be counted solely in the formal economy. Certainly, most financial transactions and services are carried out through formal channels operated either by the state or the markets. Yet, classes of society are able to access financial resources even when they were not available in formal settings, as well as distribute welfare without the direct involvement of the state.

Rotating savings and credit schemes flourished under the conditions of a strictly centralized state where any deviation from the established legal and ideological framework would be harshly punished. The socialist government was aware of the existence of these “illegal” informal arrangements. Still, its attitude was to turn a blind eye to these arrangements because they were possibly aware that the state was replaced by a citizens’ organization to deliver a service that the state was unable to deliver. Citizens, on the other hand, were relying on values and mechanisms proper to a socialist state to maintain collective action within the group. The socialist ideology coupled with social pressure and reputation and other social capital-components, such as trust, have been the key mechanisms that enabled the functioning of these schemes. Selection of the group size and monitoring strategies have been additional factors in encouraging and maintaining collective action. The common group size reached up to a dozen members who would generally be colleagues, neighbors, friends or close acquaintances. The management of the scheme was assigned to a trusted person who would monitor the actions of all members and make sure that no shirking of responsibilities and duties happens.

After the collapse of the socialist system, rotating savings and credit schemes became far less common when compared to the past in the case of Albania and Armenia. The increased mobility of people within these countries (associated with high levels of internal migration and massive emigration), job insecurity and increased levels of distrust have resulted in a general reluctance to organize such schemes. Social networks, consisting of quasi-permanent employment and residence – characteristic of socialist economies – that enabled the functioning of rotating credit schemes weakened. Finally, the socialist-style sanctioning mechanism that targeted the social reputation of individuals could no longer be effective. However, in the case of rural communities in

Kyrgyzstan and Uzbekistan, strong informal networks and social cohesion continued to persist also after socialism, therefore such informal credit schemes are still highly diffused.

Trust remained therefore central to the functioning of the schemes during both the socialist and transition periods. With low levels of trust, neither formal nor informal institutions can function, so one could assume that trust by the participants of the scheme was low towards the state but high towards other individuals, or association of individuals. This was also confirmed by a recent survey that was carried out in Ukraine (Polese and Stepurko 2016) showing that low levels of trust towards the state contrasted with high levels of social solidarity can eventually increase the role and amount of informal institutions operating in a given territory.

Through this paper, looking into the case of typical post-socialist countries, we have made a case about the capacity of individuals to organize and make up for ineffective governance structures. This can be regarded as a minus in the role of the state, allowing imperfections of the system to survive and reproduce themselves. However, scholars who are critical of the neoliberal model can see it as allowing a contribution to governance and management structures from the bottom, revisiting the role of agency in a XXth-century state. These statements, and the case presented here, however, come with some limitations. First, as in all studies based on a qualitative approach, the question of representativeness arises. How widespread were these schemes across socialist societies and its segments? Second, most of the data gathered through interviews are likely to suffer from some “historical memory bias” with risks of romanticization of the scheme. Finally, perhaps not a limitation but a question intended to bring research forward could be “how have these types of rotating savings and credit schemes evolved to fit the needs of other post-socialist countries today”?

If, on the one hand, we are convinced that the amount of information gathered and our interpretative framework has been sufficient to provide an in-depth view on the scheme and its implications, the above limitations can be regarded as a basis for further research. Future investigations might engage not only with the rotating savings and credit scheme in itself and how it evolved during post-socialist transition period, but also with the way alternative forms of governance exist, persist and are reproduced through a myriad of practices that remain under-studied or simply dismissed as minor ones but end up reshaping the way governance is designed by a state and lived by its citizens.

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## **Compliance with ethical standards**

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