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**THE SUITCASE TRADE BETWEEN
TURKEY AND RUSSIA:
MICROECONOMICS
AND INSTITUTIONAL STRUCTURE**

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The paper focused on an important dimension of contemporary international economy: the “Suitcase/Shuttle trade.” More specifically, it has examined a microcosm of the new economic geography created through the “shuttle” trade between former Soviet republics and Turkey between 1991 and 2002. The project had three main goals. One was to provide a profile of both the Turkish and Russian traders so as to acquire insights into the dynamics of shuttle trade. Second, to find out how informal networks operate and what kind of regulatory challenges do they create for the governments? Third, the authors were interested in how the contagion effect operates in the “real economy.” To address the trends of shuttle business development authors used a series of non-formalised in-depth interviews conducted with shopkeepers as well as shuttle traders in both countries in 2001—2002.

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Данная статья посвящена изучению такого важного измерения современных международных экономических отношений, каким в последние годы стала “челночная торговля”. Мы попытались проанализировать ту экономико-географическую микросреду, которая возникла в рамках “челночной торговли” между странами бывшего СССР и Турцией в 1991—2002 гг. Наш исследовательский проект ориентировался на решение трех задач. Во-первых, авторы стремились нарисовать социально-демографический портрет турецких и российских торговцев, чтобы увидеть внутреннюю динамику “челночной торговли”. Во-вторых, мы пытались понять, как действуют неформальные сети в этом бизнесе и какие вызовы они порождают для правительств. В-третьих, авторы были заинтересованы в рассмотрении микроэкономического воздействия на реальную экономику эффекта “распространения кризисов” (contagion effect), который обычно исследуется с точки зрения макроэкономики и финансовых рынков. Тенденции развития “челночного бизнеса” анализируются на основе серии углубленных неформализованных интервью, проведенных с челночными торговцами в 2001—2002 годах в обеих странах.

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1. INTRODUCTION AND RELEVANCE

This paper reflects the results of international research project “Redefining Contagion Effect: The Political Economy of the Suitcase Trade Between Turkey and Russia” supported in 2001—2002 by the International Research & Exchanges Board (IREX) with funds provided by the Starr Foundation in framework of “Black and Caspian Sea Collaborative Research Program”.

In the last twenty years global trends of economic liberalization and deregulation have created patterns of interdependence that are qualitatively different from those produced during previous episodes of globalization. In this context, the collapse of the Soviet Union and the entry of a large number of successor states into the international economy has precipitated dramatic changes, that have rearranged national economies, generated new entrepreneurial groups and reshaped patterns of consumption and production. Nowhere are these changes more evident than on the border regions of the successor states, where entirely new trade linkages have formed and reformed, particularly in the rapid rise of trans-border informal trading networks.

This research focused on an important dimension of this contemporary international economy: the “Suitcase/Shuttle trade.” More specifically, it has examined a microcosm of the new economic geography created through the “shuttle” trade between former Soviet republics and Turkey between 1991 and 2002. By focusing on a single case of informal cross-border trade this project offers some insights on much broader processes of agglomeration and contagion that link Caspian and Black Sea countries to a host of trading partners, including Pakistan, China, India, and Korea. These processes represent a new and fragile form of interdependence that links small and medium scale businesses through multiple networks of rapidly changing international transactions. As such, the suitcase trade between Turkey and Russia is illustrative of a novel aspect of contemporary globalization with important implications for a host of domestic factors ranging from regulatory regimes to social change.

Our research had three main goals. One was to provide a profile of both the Turkish and Russian traders so as to acquire insights into the dynamics of shuttle trade. Who really are these traders? How and why do they create these informal networks? What kind of a market formation is at work? What is the infrastructure of this trade, namely how is it financed? How are the goods transported from Turkey to Russia? How do the shopkeepers and the traders interact? Second, we

wanted to find out how informal networks operate and what kind of regulatory challenges do they create for the governments? How can the embedded corruption, illegality be overcome without losing the dynamism of this trade? Finally, we were interested in how the contagion effect operates in the “real economy.” The financial shocks of 1994 (Turkey), 1998 (Russia) and 2001 (Turkey) presented an excellent testing ground for theories seeking to explain the nature of financial contagion and the effects of exogenous shocks.

Hence the project’s main contribution has been to offer a profile of Turkish shopkeepers and Russian traders and explore the micro-dynamics of how informal shuttle trade actually works. Despite the growing literature on Turkish-Russian trade and economic relations, these informal trade networks have largely been overlooked. This study fills this gap. Another contribution of this study is that it offers insights into problems of governmental regulation and the challenges governments face in “formalizing” their economies. Understanding the immense growth of this informal economy in the aftermath of the collapse of the Soviet Union and the changes this economy underwent since then, can not only offer insights in the changing economic landscape in the Black Sea and Caspian region but also help governments of the region to regulate these dynamics without losing its vibrancy.

This study also sheds an original light on the financial contagion effect. While the existing literature on the financial contagion effect focuses on declining reserves, capital flights, currency fluctuations and stock markets, this study analyzes the contagion effect from a different angle by focusing on the impact of the financial crises on informal markets. The finding that macroeconomic instability tends to reinforce informal trade networks is hardly surprising. But surviving these crises has led to more stable and sustainable trade links. Unpredictability of these markets has forced both the traders and shopkeepers to be much better organized and much more risk-averse.

Practically, by redefining the so called “new interdependence” between Russia and Turkey through the lenses of suitcase trade, this study raises serious questions on the strength and degree of sustainable trade and market ties between the two countries. More importantly, by analyzing informal trading in a concrete fashion, this study improves our understanding of the logic and patterns of informal economy, which still accounts for a significant portion of economic activity in the Caspian and Black Sea region.

Finally, this study raised very relevant policy questions both at the international and national level. How can informal trading be formalized without undermining its dynamism and network advantages? What can the governments on both sides do to encourage long-term sustainable market ties? How exactly can Turkey and Russia, and indeed the entire Black Sea region benefit from this shuttle trade, particularly during times of financial crises? An analysis of the political

economy of suitcase trade between Turkey and Russia as a microcosm of overall shuttle trade in the Caspian and Black Sea region can offer insights and guidelines in answering these questions and underline the importance what appears to be a perennial feature of this region’s economy.

2. THE SCALE OF SUITCASE TRADE IN TURKISH AND RUSSIAN ECONOMIES

“Suitcase trade” (or shuttle trade) is a term generally applied to describe the massive unregulated and unregistered commerce, which became a significant part of the economic scene in the Caspian and Black Sea region since 1992. Within this growing network of shuttle trade among various countries in this region, the suitcase trade between Russia and Turkey is particularly remarkable both for its scale and nature.

Although the effects of the trade were national, generating enormous markets for Turkish goods in Russia, the transactional aspects of this trade mostly centered on Istanbul’s historic city center, Laleli. As the center of Russian-Turkish suitcase trade, Laleli offers an excellent laboratory to observe both how a given financial crisis in one of the trading partners influence the other side, and how this informal trade and finance is created, organized and reorganized. In Laleli, this involved the purchase of textiles, clothing items, light consumer goods and leather garments by visiting Russian “tourists.” What started as systematic trips on the part of many Russians to various makeshift harbor bazaars in Turkey’s Black Sea coast such as Trabzon and Hopa gradually shifted to Istanbul becoming more centralized, organized and diversified. In fact, suitcase trade has little to do with its name, as most of this trade is managed through buses, vessels and planes.

The outward appearances of Laleli belie the size and importance of this trade: at its peak in 1995, volume of suitcase trade reached an estimated 10 billion dollars during 1995. Even though it has declined since then, it still accounts for a significant source of Turkey’s exports. The sharp contrast between growing trade deficits throughout the 1990s and relatively better current account deficits is a testimony to Laleli’s significance for Turkey and its foreign currency reserves. So much so that the IMF officials pressured the Turkish Central Bank in 1996 to include shuttle trade estimates into its current account calculations. There is no dispute that suitcase trade remains important source of hard currency in Turkey.

The shuttle trade is important for the Russian economy as well, and indeed, represents only one among many important new informal trading networks in the post-Soviet era. Before the August 1998 ruble crisis, official estimation of Goskomstat on volume of shuttle trade in Russia 1998 was approximately 4.5—5,0 billion dollars per quarter and dropped to 2,0—2,5 billion per quarter after the

crisis. The share of Turkey in this overall volume is estimated to be around 40–50%. Even after the ruble crisis, shuttle trade accounted for 10.3% of Russia's foreign trade turnover, including 2.2% in exports and 24.2% in imports (Goskomstat, 2000). At its peak in 1993–94, an estimated 10 million Russians were involved in overall shuttle trade.

3. METHODOLOGY

Several general characteristics of the suitcase trade impose certain constraints on the methodology that can be adopted in our research. First, is the observation that although quite sizeable sums of money and goods are being exchanged in this market most business activities are informal if not strictly illegal. Second, although the Turkish side of the exchange, or simply the supply side, is relatively more concentrated with respect to geographic location, the buyers, or the demand side, come from a large number of countries. Even on the supply side if one were to concentrate on the production as well as retailing of the supply network, the geographic concentration start to get more dispersed and widens over to a number of Istanbul neighborhoods as well as other Anatolian provinces such as Gaziantep and Denizli. Thirdly, besides the informal nature of the market structure the goods and services being exchanged are quite heterogeneous in character. As one moves from one particular product group to another the nature of the relations potentially can change significantly. Moreover, it seems that besides the goods that fill the suitcases, the travel and accommodation as well as transportation services also form a good part of the trade. Besides these general characteristics of the market of interest one should also underline that since very little is known about the way supply as well as the demand sides of the market are organized the primary objective of our research aims to be exploratory rather than hypothesis or testing driven.

One important implication of the informal nature of Laleli suitcase trade is the difficulty of obtaining reliable and accurate quantification of many of the interesting aspects of the market. For instance, sales figures yearly or monthly are difficult to obtain. We chose not to dwell on these issues at this stage but depending on the rapport established with the shopkeepers a rough estimate was obtained. For those who are engaged, besides retailing, also in production, we tried to obtain employment figures. However, since many employees work without social security and thus are paid under the table, similar non or under reporting should be expected there as well.

In short, we aimed at obtaining a qualitative description of the informal networks in operation at Laleli as a tool to understand the mechanism of finding the customers, bringing them over to the neighborhood, having them stay in a con-

venient neighborhood hotel, getting them around the Laleli market, providing them with credit arrangements, shipping their goods and staying in touch until the next visit. As such, we hoped to formulate a certain descriptive tool and also to derive testable hypotheses.

4. SAMPLING

On the Turkish side a total of 40 in-depth interviews were conducted throughout the year with the shopkeepers in Laleli, the main area of shuttle trade in Istanbul, largely concentrating on the dynamics and patterns of shuttle trade. The sampling on the Turkish side was done in two stages. The first stage was to screen the Laleli area so as to map out the kind of activities carried out in the region. These screening questions aimed at profiling the shopkeepers and their products. The screening questions were also designed to ensure that our in-depth interviews were as representative a sample as possible. A total of 120 shopkeepers were screened in and around Laleli, but 10 refused to answer.

The second stage was in-depth interviews with the shopkeepers. Here, we paid attention to the following factors. The shopkeepers covered as wide range of goods including all kinds of clothing, leather and leather goods (shoes, purses), jewelry, upholstery, household accessories, automotive parts. The size of the shops was also different. Some were exclusively engaged in sales, some engaged both in production and sales and some were exclusively engaged in transportation. Our in-depth interview sample reflected these differences. 4 cargo companies, 4 big companies with sales and production, 3 shoe shops, 3 jewelry shops, 3 leather goods shops, 1 automotive parts shop, 1 office supply shop and 3 upholstery, 13 clothing shops (jeans, T-shirts, sleep wear, women and men clothing) were interviewed in Laleli. The distribution of these shops was based on the initial screening results. 5 more clothing shops were visited in Osmanbey, which sells upper niche products for the Russian market. Additional interviews included the head of LASIAD (Laleli Business Association), MESIAD (Merter Industrialists and Businessmen Association), 1 tourism agency and 2 hotels.

On the Russian side as well, because of the informal character of the trading operations of the *chelnoki* the major source of information concerning this type of business are the interviews with its direct participants. 24 interviews with the *chelnoki* were carried out within the frames of the first stage of our project. One additional interview was provided with representative of large travel agency organizing shop-tours to Turkey and Italy. Half of the interviews were conducted in Moscow. This is due to the fact that Moscow still remains to be the largest center of shuttle trade. Market in the capital (*Luzhniki, Izmailovo, Tchelkovo*, etc.) are the trans-shipment points from where the goods of shuttle imports are distributed into the regions.

Kursk and Yekaterinburg were selected with the consideration of objective possibilities for the conducting of the interview as well as their geographical position. Kursk, in particular, was appealing due to its relative proximity to Moscow: local *chelnoki* acquired the possibility to buy the same Turkish products on small wholesale markets in Moscow instead of purchasing directly from Turkey. Apart from that Kursk is situated on the way from the center of Russia to Poland, which allowed us to make an indirect evaluation of the competition between different shuttle trade destinations and define the comparative advantages and disadvantages of doing business with Turkish partners. Similarly, local *chelnoki* in Yekaterinburg had the possibility of choice between the Turkish and Chinese destinations. These interviews on shuttle traders were supplemented by 17 shuttle trader interviews that were conducted at random from those buyers who were visiting the shop during our interviews with the shopkeepers.

5. FINDINGS

5.1 Profiling Turkish shopkeepers

The screening questionnaire was applied to a total of 110 shopkeepers. As Table 1 below shows 33% was in ready made clothing and 22% in textiles business. Leather (15%), shoes (8%), leather goods (7%) comprise another 30% of the total.

When asked about their field of operation 37% of our respondents indicated that they were in solely trade. 63% however said they were in both trade and production.

For those who are in trade we also asked the percentage of their total sales to the domestic market and the percentage of total sales to the foreign market. The

Table 1.

<i>What is your field of operation?</i>	<i>No</i>	<i>%</i>
Ready made clothing	36	33
Textiles	24	22
Leather trade	16	15
Shoes	9	8
Leather goods	8	7
Spare parts, scrap goods etc.	5	5
Upholstery	5	5
Goldsmith	4	4
Stationary	3	3

trade sector shops we talked to indicated that on average 18.5% of their sales is to domestic and 81.5% is to the foreign markets. As Table 2 below shows among the countries they most frequently sell to, Russia (91%) tops the list, followed by Romania (38%), Bulgaria (30%) and Ukraine (25%). We also observe that about 28% of our respondents also mention Arabic countries and Tunisia especially. Azerbaijan and other Turkish Republics are also present in about 19% of the respondents' list of countries. Serbia, Croatia, Macedonia and the old Yugoslavia is present in about 30% of the respondents' list of countries.

Only two of our respondents indicated that they have a Russian partner. But among the in-depth interviews, some have indicated that they have broken-up their partnerships in the aftermath of the 1998 crisis.

As Table 3 shows we observe an average of about 25 people employed in our respondents' shops. In 69 of our 111 shops (62%) we also have family members working. We observe that in those 69 shops on average 3 family members were also working. In only 8 shops we observed part time employees. However, when there are part time employment the average per shop is quite large, about 18 workers.

Table 2.

<i>Which countries do you sell your goods?</i>	<i>No</i>	<i>%</i>
Russia	99	91
Romania	41	38
Bulgaria	33	30
Ukraine	27	25
Poland	24	22
Arabic countries	22	20
Yugoslavia	18	17
Hungary	15	14
Azerbaijan	14	13
Czech Republic	13	12
Tunisia	9	8
Israel	7	6
Macedonia	7	6
Turkic Republics	7	6
Moldavia	5	5
Albania	4	4
Serbia	4	4
Croatia	3	3
Georgia	3	3
Armenia	2	2

Table 3. Employment Structure

How many full time workers are employed in your enterprise?	Mean = 25
Are there any family members employed?	Yes = 69
If yes, how many	Mean = 3
Are there any part time employees?	Yes = 8
If yes how many?	Mean out of 8 yes answers = 18

The screening process followed by in-depth interviews, helped us identify three main solidarity groups could be observed in the Laleli region. One is the migrant community, who had largely moved to Laleli in the early 1990s, and is largely from the Balkans, particularly the former Yugoslavia and Bulgaria. This group mostly run family businesses and continues to bring in their friends and relatives from their respective regions. This is also the group with least amount of adjustment problems to the Laleli market as most speak Russian. The second group's basis of solidarity is Islamic. This group has a high ratio of home-town folkship as well, as they bring in "their kind of people" into the business. This group of traders largely resent the "negative image" often attached to the Laleli market largely due to the tourism and prostitution in the area. They are highly conservative but are just as ready and willing to usurp the opportunities offered in the market. Final group are the Kurds who had most migrated to Istanbul in the early 1990s largely due to the escalation of the conflict in the southeast of the country. This newcomer group is largely blamed by the early traders in the region, as being after the "easy money" and "one big-shot trading" rather than establishing long-term, sustainable shopkeeper-trader relations. Kurds are also blamed for being part of the prostitution and drug trading in the area.

While some traders (3 in our sample) have been in business for more than 30 years, most had started their business in the late 1980s and early 1990s with the collapse of the former Soviet Union. All shopkeepers were male between the ages of 25 to 60. Only one owner of the cargo company was a woman. Shopkeepers prefer doing business in Laleli mainly because of the dollar-based sales and the availability of customers. The producers also like to produce for the Laleli market since they get paid at the end of the week (mostly Fridays) in cash which sets up a sharp contrast to the domestic market where the business is run based on long term checks.

As noted earlier more than 80% of the sales in Laleli are destined for Russia and former Soviet Republics. Almost all of the shopkeepers work exclusively for the Laleli markets though some continues to work for domestic market as well. There has been some diversification, albeit limited, of regional destinations largely due to

the crisis effect. These destinations mostly include the countries listed in our screening results. The business is extremely volatile and price sensitive. Almost of the interviewees have either gone bankrupt once in the Laleli market or had to scale down significantly due to changes in demand. Most of the transactions take place in cash dollars though short-term credits, or payment after sales are also common. Shopkeepers attribute their success and their survivability to their ability to respond to the changes in taste and fashion, high skilled and cheap labor along with the convenience of Laleli with cargo companies, tourism agencies, all located in one place.

Shops vary tremendously in size from small street vendors to three and four outlets in the Laleli region. Half in our sample was also involved in production. Shops with revenues larger than an annual 200,000 have shifted to production in the aftermath of the 1998 crisis. Finding reliable revenue numbers, however, has been impossible as most shopkeepers refused to answer questions on revenue. Some estimation, however, is possible. For instance, while a few shopkeepers own their stores, most pay rents for the shops and complain about the high rental prices. It was the 1994 financial crisis in Turkey that has led many merchants to wake up to the lucrative aspects of the Laleli market which is why the rental prices have skyrocketed since then. At its highest, the Laleli merchants claimed that they paid an annual average rent of \$150,000 to 300,000. If the average business in Laleli pays between \$150,000 and \$300,000 a year for rent and another \$100,000 for utilities, labor, and general/administration, it is reasonable to assume that a merchant would have to sell \$1 million in gross volume to cover the cost of goods and to earn enough profit to stay in business. This would yield roughly \$5 billion in sales for the estimated 5,000 shops in Laleli. (The number of shops, however, is also a very rough estimation.)*

Most of the shopkeepers have said that they either used their own personal savings or borrowed money from relatives and friends to start their business, which again points out the folksmanship in the informal networks. The importance of "family business" is very evident. None has ever used bank credits. 95% of business is done on a cash basis. Very few shops provide credits (maximum 5% of their client base and no more than a month) to their customers. But the credits depend whether it is permanent customer or not. Otherwise, Advance payment is common. Overall, there seems to be two types of traders in the Laleli market. The most experienced traders fax or phone their bulk orders to the shop-

* The Turkish Central Bank used a quantitative research technique called "self-completion method" to estimate the suitcase trade. A survey was carried out by interviewing tourists from the former USSR who came to Turkey to buy goods in the Laleli. Several different statistical methods were used to calculate the value of the goods bought. The selling price of the goods, transportation cost, and personal expenses were all taken into consideration in the calculation of per capita expenditure in 1996, which the Central Bank estimated was roughly \$8,700. The cb also estimated that 64 pct of CIS tourists — roughly 1 million people — came to turkey last year to participate in the suitcase trade. As a result, it was estimated that suitcase trade amounted to \$8.8 billion in 1996. Istanbul, Laleli accounted for 70% of this volume.e.

keepers. If they are regular customers, no payment is demanded until the goods are delivered. Otherwise, the shopkeepers expect cash before shipment. The second group of traders is less experienced; they come to Turkey by plane or bus, do not buy in bulk, and usually pay before shipment.

Most of the shops employ foreigners, mostly women from CIS countries, as temporary help as well as to solve the language problem. They pay roughly 50–70 dollars a week during the peak season, or 5–10 dollars a day depending on the work. Long term foreign employment is problematic because of difficulty of work permits for foreigners. As noted in the screening results, however, with an average of 25 people employed in these shops and taking into account the backward and forward linkages, the garment makers, ready made clothing, cargo companies, hotels, travel agencies, Laleli generates significant employment in the textile sector.

Finally, significant level of informality is evident among all shopkeepers. These include, failure to pay full taxes even though all pay some taxes, hiring temporary, illegal workers, opening shops illegally or working jointly with street vendors. Among the cargo companies, the level of informality/illegality increases, as these companies admit sharing some of their profits with the customs officials on both sides for preferential treatment.

5.2 Profiling Russian traders

On the Russian side — see table 4 for details — women dominated our sample and half of the respondents have high education (one even has a PhD [candidate of sciences — Russian degree]). Both tendencies can be considered typical for the Russian shuttle business. They were, in particular pointed out by Ilyina & Ilyin (1998) on the basis of the results obtained by sociological research of the trade participants on the open-air market in Syktyvkar. Women are predominant in our sample (2/3 against men's 1/3), and, according to the interviews, this is typical for such business. Among the reasons explaining this phenomenon the respondents cited a higher flexibility of women, better bargaining skills, the ability to attract a potential customer and to persuade her/him to make a purchase.

The age distribution of the respondents is quite large, from 25 to 45 years. Apparently most typical are the *chel'noki* in their thirties. Frequent trips with climate changes are not burdensome for the people of this age. (“No, I won't go myself for pullovers to Turkey. I'm old now,” says Maria from Kursk, age 44). At the same time this market is not so much accessible for young people as it has been before. Many came into shuttle business in 1990s immediately after college or university graduation and unsuccessful attempt to find an employment in line with their training. Now, however, before starting an individual business you have

to work for 3–4 years as a hired salesperson on the market. People possessing a start-up capital have other kind of new and more interesting opportunities.

The prevailing majority of the respondents firstly get started in the shuttle business before 1996. According to our sample the flow of people into this business renewed after 1998 crisis, although it only occurred because of the provinces. All Moscow respondents came into shuttle trade in 1992–1994. This factor apparently explains the age difference of our interviewees in various regions. Thus, average Moscow age of our respondent is 39 years, while Kursk average is 34 and Yekaterinburg average is 31. In addition, the average work experience in shuttle trade is 8.5 years in the capital, while the same variable is 4 and 6,5 for the respondents from Kursk and Yekaterinburg respectively.

Table 4. Major sampling parameters for Russian traders

<i>Indicator</i>	<i>Value</i>	<i>Number of Respondents</i>
Age	Less than 30	8
	31–40	10
	More than 40	6
Gender	Male	8
	Female	16
Place of Residence	Moscow	12
	Kursk	6
	Yekaterinburg (region included)	6
Education	High	13
	Semi-finished high and specialized secondary (professional technical school)	9
	Secondary	2
Date of entering the business	1992–1993	12
	1994–1995	6
	1996–1997	2
	1998 and later	4
Type of present-day activities	Receives goods from Turkey and regularly goes there	21
	Buys Turkish goods on wholesale market and sells them in retail	2
	Quit the shuttle business	1

The 17 shuttle traders interviewed on the Turkish side as well and had a rather similar profile with the trader interviews conducted in Russia. The following suggestive observations and comparisons could be made between the shuttle traders in Laleli and Russian interviews.

Sex structure. About 1/3 are men and 2/3 — women (it is close to Russian data).

Geography of trade and transport. The main part of traders comes from South regions of former USSR or Volga/Ural regions. Possible explanation here is lower transport costs. People from South often come with buses or ships. From Russia they come only with planes and mostly through Moscow.

Years in business. It is comparable to Russian data without Moscow. The most part started in early or mid 1990s. According Russian data some new people from regions came to this business after the crisis 1998. According Laleli data two respondents (both from Ural region) could return to the business in 1999—2000.

Shuttle trading in other countries. Half of respondents (9 of 17) have trade experience in other countries. The most popular countries are Poland (5 respondents), Italy (2) and China (2). It is interesting that both respondents from Central Russia (it is region with higher incomes and higher quality requirements) started their shuttle trade in Europe — Poland and Italy — after crisis 1998.

Trade preferences. There is some hierarchy: cost minimization (in terms of money and time spending) is important by choice of the market. Quality is important by choice of shop and concrete goods. 9 respondents directly spoke about it. At the same time for 10 traders their choice is based on previous experience or recommendation — that is equal to quality! At the same time the quality of goods is the main problem for shuttle traders in Laleli (8 respondents).

Trade turnover and credit. Taking into account average number of trips and money spending on each shopping it is possible to calculate the annual trade turnover of respondents. One can observe that 1/3 spends in Turkey between \$20000 and \$60000 per year (more typical in this group is volume 25—30 thousand USD) and 1/3 spends between \$60000 and \$120000 (typical in this group is volume 80—90 thousand USD). It is interesting that Russian traders usually have larger trade turnover. There are not Russian in the group with trade volume less \$20000 at all and 5 of 9 Russians belong to largest group. Large amount of purchases is the base for development of credit relations with shopkeepers. In general credit after crisis 1998 is seldom but 3 of 6 traders in largest group can take it sometimes.

Sales channels. The most popular is retail [or open-air] market. At the same time 1/3 of respondents are owners of stores. But it is interesting that share of Russians in this case is lower. It is close to Russian data. Many respondents would

like to buy a store but in cities it is very difficult, at the same time the rent is high (especially in Moscow — from \$1200 till \$3000 / sq.m. per annum). Probably it is easier to buy a store in other former Soviet republics — because 4 of 8 non-Russian traders own stores.

5.3 Infrastructure of shuttle trade

The Turkish side: The suitcase trade clearly does not involve only the shopkeepers and the traders. A whole series of businesses has sprawled in Laleli, including the tourism agencies, hotels and most importantly cargo companies which feed out the shuttle trade.

In the early 1990s, traders transported Turkish goods back home mostly by train, bus or boat in suitcases, but air transport have now become more widely used. At its peak, Turkish airlines had over 55 passenger flights a week between Turkey and the CIS, Romania and Bulgaria with a carrying capacity of close to 10,000 from those places to Istanbul. In addition, the national airlines of Russia and Ukraine fly to Istanbul ten times a week from Moscow, St. Petersburg, and Kiev. Using central bank estimates that 64 percent of CIS tourists coming to Turkey are suitcase traders, Turkish airlines and the Russian and Ukrainian carriers were bringing roughly 7,000 traders a week to Turkey. These numbers have declined more than by half since the 1998 crisis. The shopkeepers claim that they have lost business to China, East Asia and Arab markets.

Cargo companies play a crucial role in sustaining this shuttle trade. The payment for most truck shipments are made on a cubic meter basis rather than the weight. The weight is more important in the planes. These companies work closely with travel agencies which bring the customers, arrange the hotels for them. Just like the shopkeepers 80% of their customers are permanent customers who use them on a systematic basis. Most of the cargo companies also have joint ventures with Russian, Moldavian and Romanian counterparts. Each partner is responsible until their respective border. This is a rather oligopolistic competition among the cargo companies for certain destinations. The higher the volume of trade, naturally, the higher the number of companies. For smaller regions, there is a monopolistic market for one cargo company serving that region from Laleli. The fees for cargo change depending on the volume and the nature of the product. The bigger the volume, the lower the unit price. In leather, a cargo fee for a plane is 3.5 dollars per kg but other clothing would be 2.5—3 kgs. (The profit margin in leather is higher. Some cargo companies accept 10% commission regardless of weight. Roughly planes are twice as expensive as carrying through tractor-trailers. In both cases, the goods of the customers are pooled together and loaded. Some companies even own their own charter planes. Trucks, tractor-trailers tend to be rented from CIS countries.

The shopkeepers often stated that “real money” is being made in the cargo business. The business, is risky, however, as it involves passing customs officials and establishing the necessary networks for “unproblematic” passage of goods, i.e. knowing the right people at the right place. (Most shopkeepers also claimed that these cargo companies have mafia ties. Obviously, we were unable to verify that.) Even though, there is some history of “goods lost in the way”, most customers seemed satisfied by the service but complained about the high prices. The shopkeepers do not work directly with the cargo companies but simply deliver the goods their clients wanted to the cargo company again designated by the customer.

Another business is the warehouses where the customers can leave their goods for one dollar a day. Finally, the so-called cargo boys help the customer carry their goods from the shops to the cargo companies which are conveniently all in Laleli.

Last but not the least, hotels in Laleli are crucial for the shuttle trade. There are some estimated 500 hotels in the region some subject to regulation from the municipality, some from the Ministry of Tourism. Most hotels work closely with travel agencies in Russia, which in turn tend to have partners in Turkey. (These agencies offer special packages which include a round-trip ticket to Istanbul, and a few nights stay, approximately 300 dollars). The hotels have very different rates for these clients. (Some offer as much as 60% discount on daily prices.) Most hotels in Laleli have also changed their conference rooms to warehouses for the shuttle traders. This allows the customers to leave their goods in the basement of the hotel and then transfer that to the cargo company with which the travel agency works. Agencies usually work two or three hotels in the region.

Russian side: As was the case in Turkey, shuttle trade boom in early and mid 1990s stimulated development of many other business in Russia — like travel agencies specialized for shop-tours, cargo companies, new hotels etc. This infrastructure helped the shuttle traders to decrease their costs (first of all in terms of time saving) but at the same time it gave advantages mainly for larger operators. Real costs per one trip could be even higher (in early 1990s it was 100—150 USD, in mid 1990s one week shop-tour to Istanbul cost already about 400 USD) but you could buy more goods spending less time and having less risk.

Crises 1998 had negative impact on development of these infrastructure institutes. But they existed already, they wanted to survive and they tried to find new opportunities for shuttle trade development. One interesting example described our respondent from large Russian travel agency. This agency organizes shop-tours to Italy and Turkey. It offers very low prices — 275 USD for one-week shop-tour in Italy. And only external cost of this shop-tour (brokerage of retail travel agency, wholesale charter ticket, accommodation, transfer from airport and back) is about 350 USD. Of course this company has some internal costs. However this business is quite profitable. The main source of profit is com-

mission from Italian and Turkish trade centers and factories, which goods are sold to travel agency’s clients. According to formal contracts between travel agency and its partners level of this commission is usually 10—12%. Purchase volume of travel agency’s clients is 0,8—1,0 million USD for Italy and 1,2—1,5 million USD for Turkey per month.

As additional incentive for shuttle traders to buy goods at partners store and stocks this company offers for its clients special bonus program. So, if you spend 2001—5000 USD you can get back in Moscow 100 USD. If you spend 5001—7500 USD — your bonus is 200 USD etc. Check and receipts collected allow for travel agency to control the payments from its Italian and Turkish partners.

Of course it is not necessary for shuttle traders to visit only stores and stocks, which are included in travel agency’s program. But travel agency itself tries to choose partners with good price/quality ratio — because in other case clients will buy goods in other stores and travel agency can not cover its cost on organization of shop-tour. And this marketing policy is successful enough — about 1/2 of ‘tourists’ each time are regular clients of this travel agency.

This case is interesting as an example of *integration* on the base of *concentration*. Italian and Turkish producers can regularly offer such discounts (10—12%) only if they expect as result the significant increase in sales. It means that travel agency must attract more clients per time unit. It must *concentrate demand* for its partners. And therefore travel agency lowers its prices, introduces the bonus program etc. But it is reason already for the *sharpening of competition* and *new concentration* in the shop-tour’s market. At the same time it is the way to *more formality of shuttle trade* — because there are formal contracts between travel agency and Italian/Turkish factories, trade centers, store and stocks; shuttle traders interesting in bonus prefer formal payments on the base of checks and receipts. But it means that stores and stock also should operate formally.

6. ANALYSIS

6.1 The contagion effect

The frequency and severity of financial crises accompanying tighter global integration of financial markets has focused scholarly attention on the political economy of managing financial crises in the emerging markets (Wade, 1998a and 1998b, Eichengreen, 1999, Haggard, 2000). The 1994 Mexican peso crisis, 1997 Asian crises, 1998 Russian crisis, 1999 crisis in Brazil and, most recently, the February 2001 financial crisis in Turkey, drew attention to the volatility of the financial markets and the resulting vulnerability of national economies to flux in global equity markets. The growing literature on the causes and effects of these financial crises

created significant amount of debate. While many focused on overall macroeconomic instability, exchange rate mismanagement, high public debt (or corporate debt as was the case in East Asia) and vulnerabilities embedded in the real economy, others focused on the volatility of financial markets and dangers of self-fulfilling speculative attacks (Obsfeld, 1996). Still others saw the crisis a natural result of premature financial liberalization without sufficient regulation and pointed out to the problems associated with the IMF (Radelet and Sachs, 1998).

Although there is no consensus on what triggers financial crises, most scholars agree that open financial markets create “contagion effects” through which devaluation or a financial crisis in a given country creates financial problems in other emerging markets. This occurs either through actual competitive devaluation in the emerging markets, or with the expectation of the investors and creditors that the other emerging markets will follow suit. This “rush for the exits” strategy of portfolio investors in the global economy and rapid capital withdrawal what Radelet and Sachs (1998) a “rational panic” in effect spreading the crisis from one emerging market to the other.

Existing studies of the financial contagion effects (Calvo, 1999; Kaminsky and Reinhart, 2000) largely concentrate on how the international investors, international institutions including the IMF along with the developing country governments fail to adapt to the new global equity markets. Few scholars go beyond the study of financial dynamics in studying the actual dynamics of the contagion effect. Those who do, often concentrate on macro level data, which emphasize how financial crises lead to significant shifts in volume and direction of trade or overall dynamics of economic growth. The existing micro-level analyses, on the other hand, almost exclusively focus on how financial crises change the investment strategies and options or how IMF bail-outs might create the so called moral hazard problems in international investors (Kahler, 1998). In sharp contrast to the existing literature, this study has offered a micro- analysis of financial crises through the study the effects of contagion on the real economy since workers and entrepreneurs in the highly labor intensive export production sectors of Turkey are among the first victims of financial volatility.

Indeed, what happened to the Laleli shuttle trade market in the aftermath of 1994, 2001 Turkish financial crisis and particularly in the aftermath of the Russian 1998 crisis is very telling and provides a proof of the fragility of this trade. Although the Turkish shopkeepers were able to survive the 1994 financial crisis in Turkey largely due to huge devaluation, they were most impacted by the August 1998 Russian financial crisis as their goods became too expensive for the shuttle traders with a devalued ruble. Though estimations vary, three out of four shops in Laleli is said to have gone through significant contraction of business during this period if not outright bankruptcy. In terms of the numbers, the volume for trade declined from 109,094 tons in 1996 to 61,114 tons in 112 and only 12,095 tons by the June of 1999.

Similarly, the number of flights to and from Russian federation and CIS countries dropped from an annual 28,040 flights and more than 2 million passengers in 1997 to 5,301 flights and 383,537 passengers by June of 1999 (LASIAD, 2000).

Four fundamental impact of the August 1998 crisis could be observed: One is that the shopkeepers had to compete based on both the quality and pricing. Since customers were no longer abundant as it used to be, they had to improve the quality and offer lower prices. The profit margins declined significantly, pushing the one-timers out of the market. The 1998 crisis also seemed to have a tremendous impact on the production side. Small and large producer firms who were working on a subcontracting basis with the Laleli shops went under as the shopkeepers were not able to pay for the goods or returned most of them

Second, the ones who survived mostly decided to get into production themselves. Overall, the number of firms who is engaged both in production and sales has increased since the crisis. Only those shops that have developed long-term partnerships with their Russian counterparts appear to have survived the crisis. Many shopkeepers also claimed that their customer service improved tremendously after the crisis as they no longer took the traders for granted and tried to lure them with more quality.

Third, because of significant collapse of the credit system and the unprecedented rise in non-returning credits, usury mechanisms, various informal lending and crediting mechanisms along with prostitution are said to increase. Overall, however, both the shopkeepers and the shuttle traders agree that suitcase trade had become more organized and more professionalized in the aftermath of the 1998 crisis.

Finally, even though the 1998 crisis was a big blow to patterns of trust between traders and the shopkeepers, those who survived the crisis were able to establish more long-term relationships. This finding is also supported by the Russian data. In effect, surviving the crises, through long term credits, giving goods without payment, no payments until the next trip showed how the informal markets can quickly adjust to the changing environments. It is this flexibility that gives the shopkeepers their edge. This also explains why the shopkeepers and producers keep returning to this market even after several bankruptcies. (“Laleli bankrupted us, but Laleli also made us rich” said one producer.)

Another evidence of volatility and fragility of the shuttle trade came during the 1999—2001 IMF program implemented in Turkey. The currency-peg system that the Turkish government adopted resulted in an overvalued currency, in effect, making Laleli goods more expensive in dollar terms. Most shopkeepers complained that they have lost significant amount of business to East Asia, China and Gulf states during this period. Laleli market, overall, appeared to be delighted with the Turkish currency devaluation in February 2001 and the market is said to have boomed since then. The shopkeepers also claim that the overall Turkish-Russian

relations also impact the volume of trade. Problems over Chechen question, issues related to pipeline projects, for instance, are all said to influence the dynamics of trade in Laleli. Finally, Laleli trade is most susceptible to changes in the customs regime in Russia. Any change in the customs regime as was seen in the aftermath of the 1998 Russian crisis, also had a detrimental impact on the flow of trade.

These findings confirm our initial hypothesis that financial crises can significantly boom and bust the shuttle trade between Turkey and Russia. The contagion effect as experienced in the Laleli market then is extremely high, which raises significant questions on the reliability and sustainability of this type of trade in the long run. This rise and fall of Laleli also points to the detrimental effects of financial crises on both sides.

6.2 The issue of trust

At the start of our project our expectations as to the role of trust within informal networks of Laleli trade in explaining behavioral patterns were quite extensive. The observation that the role of illegal activity and organized crime in a rapidly expanding environment of private property transactions was common in both post-1980 Turkey as well as Russia in the aftermath of the fall of the Berlin Wall led us to the expectation that trust based relations will derive the Laleli market where the undergrounds of both countries met. In both countries, the actors within the Laleli trade appeared to thrive on informal business links both domestically as well as internationally and left an impression of bordering on illegality particularly in finance. We were able to observe interesting patterns and several hypotheses have emerged. Below we provide a short review of the theoretical framework followed by our observations in the Laleli market and further questions that wait to be addressed.

The concept of trust plays a key role in our understanding of informal relationships and especially those that are informal and illegal. Fukuyama (1995) sparked the recent increase of attention on the concept of trust. However, discussions on conditions and features of modernity also argue that trust is an integral part of modern societies where future risk minimization requires presence of both as a regulatory mechanism as well as a public good (See Giddens, 1990; Beck, 1992). In the aftermath of the collapse of the Soviet system, discussions concerning the cultural bases of sustained economic growth has also gained importance. From an economic perspective free market and from a political perspective representative democracy were seen as prerequisites for sustained economic growth and both depended on interpersonal and social trust. The source of trust as public good or social capital is seen to lie in civil society (Seligman, 1992; Wolfe, 1989, Gellner, 1988). On different aspects of trust in modern social theo-

ry see articles in Gambetta (1988), Warren (1999), Phar and Putnam (2000). Barber (1983), Misztal (1996) and Hardin (1993) and Seligman (1997).

According to Gambetta (1993), the inability of the state to resolve disputes fairly and efficiently creates a search for alternatives (See also, among others; Varese, 1994). In decreased legitimacy of the state's formal ties to citizens and lack of competence therein, "people may trust each other because of close personal ties that depend on kinship, business links or friendship" (Rose-Ackerman, 1999, 97). Since Laleli trade is mostly outside the legal boundaries of Turkey and Russia, it provides an interesting case of transboundary informal and illegal business ties.

Our observations in the Laleli market confirm many of these expectations in the literature. First of all, the parochial nature of shopkeepers' network is unmistakable. All shopkeepers we talked to were surrounded by a network of family members and/or "hem^oehri"s. Most of our shopkeepers indicated that a hem^oehri or family member helped initiate their business. It seems that the financial aid, social comfort and security that such a surrounding brings is indispensable for establishing a business in the Laleli environment.

As to the illegal side of Laleli activities we were only able to grasp few clues. People were reluctant to talk about illegal and exorbitantly high interest rate financing that we heard from the grapevine. All seemed to have heard about such usurpers but no one indicated that they personally have had an experience. All nevertheless accepted that they have at one point had to get a "friend" or "family member's" financial aid. Obviously, such money lending activity is indispensable for shopkeepers who indicate that they use very little services from the banking sector. This is hardly surprising since the bulk of their income is unreported in official accounts. We believe that many of these "friendly aids" were obtained with usurpers' interest rates. It would be interesting to obtain some quantification in a later study for such borrowing activity, their terms so as to get an estimate of its spread in the market.

As to the trust relations between the shopkeepers and their customers from abroad, we obtain a mixed picture. On face value, almost all of our shopkeepers indicated that their customers especially from Russia and other eastern European countries are very trustable individuals. A sense of admiration for their levels of education and culture surfaced after a few questions concerning their personal relations with them. It is interesting that many expressed a distrust and disgust for the customers from many Muslim countries such as Azerbaijan, Egypt and Iran but in contrast highly praised the moral values of their cultured customers from Eastern Europe. Nevertheless, nearly all of their economic ties with their customers are cash basis. Our shopkeepers admitted that they sometimes allow for their customers to buy on credit but this obviously was an exception. An exception that was necessitated due to tough market conditions or simply occurred because of a trusting relationship that was built over time and maintained on a regular

interaction basis. Such mechanisms of trust building interaction necessitates long-run relations which many talk about but only few, in our opinion, actual have with their customers. This is not surprising since recurrent crises seem to eliminate generations of traders and help creating new ones. What is interesting here is that we observed very little initiative on the part of the shopkeepers to actually help create new customers through financing of some sort. This seems more of a function of their own inability to provide such financing aids than anything else. Nevertheless as the degree of regularity in shopkeeper and customer interaction increased the expression of trust and thus credit based relations seem to increase.

Studying social networks in Laleli and various relational ties, be they transactions, communications, instrumental relations, sentiment, authority/power and kinship (Knoke and Kuklinski, 1991, Scott, 1991) offers insights into the dynamics of informal economy on both sides. We need to further study such long-term relations based on trust in depth by locating several such relations and undertaking in depth case studies for them.

Another facet of trust relations involves those that involve the state on the one side and Laleli shopkeepers and customers to which we now turn.

6.3 Relations with the state: why is it informal?

Almost all of the shopkeepers interviewed expressed very low level of trust to the state, be it the municipality, the police or the tax collectors. When asked, what the state can do for them to improve their trade, many asked to be “left alone.” Many shopkeepers complained about the arbitrary practices of the tax collectors, (when the market appear to boom, tax collectors visit more often), the municipal officials, who change the rules and regulations on a systematic basis, and the police who fail to provide security for the shopkeepers and shuttle traders. Almost all of the shopkeepers openly admit that they resort to bribery to solve these problems and that this practice is “very much the rule of the game.” Bribing is also extremely common for customs officials. Cargo companies suggest, “Nothing can get done without bribing.” Some even suggest that there are market-set prices for bribing the customs, municipalities and tax collectors. (If you would like to open a shop in the basement of a building, for instance, which is on paper illegal, 100,000 dollars will be enough.) The arbitrariness and inconsistency in the implementation of rules and regulations is the main reason as to why the shopkeepers prefer to solve their problems in an informal fashion. Unrealistic tax rates particularly when it comes to hiring workers formally, too much paper work and bureaucracy, inability of the government to provide any services in return, such as good landscaping, transportation, parking and traffic services are all cited as reasons as to why the shopkeepers are reluctant to go formal. More importantly,

most shopkeepers suggested that all of these government officials, from tax collectors, to customs officers to the police have “entrenched interests” in maintaining this informality as they earn significantly higher than their low-level government salaries. Hence, the government has intrinsically become embedded into these informal networks that may prove extremely difficult to disentangle.

What most of our shopkeepers are not mentioning of course is their keenness in building and maintaining corruption networks of their own within the local and central government bureaucracies. It takes two to tango, in other words. The vulnerability of Laleli shopkeepers facing a determined central or local regulatory agency is obvious in the tax declarations any one is able to observe in their shops. The figures on these tax declarations are not even high enough for face saving operations. So, if a determined tax collector team comes they can be easily prosecuted. However, this almost never happens. The reason is two folds; one is that the conscious policy is to let the Laleli market do as it pleases when it comes to taxes. The other one is that if a decision to act against this undeclared decision of “laissez faire” is taken then almost everyone maintains a trusted bureaucrat to rush to its help. Similar vulnerability exists from the perspective of municipal regulations concerning health and safety in Laleli shops. Very few shops obey these regulations and all are let go by the municipality. Shopkeepers certainly pay for getting this type of blind eye when it comes to government regulators. However, they also suffer from lack of adequate services from both the local and central government. The municipality is expected to take care of street lightening, cleaning and parking facilities. Many shopkeepers complained about illegal opening of bars and running of prostitution centers in local hotels, which they claim are being let operate by the government. A ring of central government and local municipality officials seem to coalesce with local interests to get their cut out of this illegal activities. Shopkeepers seem to have been divided into two. One branch seems to opt for illegal prostitution and related activities and the other, which seem to have exclusively talked to, focus on Laleli trade in goods rather than persons. What we so far failed to observe is the degree to which these two branches are related or dependent on one another.

Another critical aspect of these corrupt interactions is their link to competitiveness of the Laleli market. If central and local regulations concerning the shopkeepers and their trade were to be fully applied one could claim that their competitive edge against their competitors in other parts of the world would be lost. This of course depends on the extent of state capture from the Laleli market. The level of state capture through corruptive links should be strictly lower than the cost of abiding by the rules. The cost of imposing these rules and working the regulatory machine so far is non-existent since these simply do not work. What seem to be in effect is a conscious policy followed by central as well as local government officials to cash in their authority of being at the regulatory positions and

capturing some portion of the rent created by Laleli shopkeepers. Instead of channeling these rents into public funds and transforming them into public goods of local use such as parking facilities, street cleaning and garbage collection as well as simple security these captured funds are being privatized into the private budgets of the network of bureaucrats in the area. So much so that the Laleli shopkeepers were hiring private security guards not only for their shops but also for the whole street in some cases.

7. CONCLUSIONS AND POLICY RECOMMENDATIONS

The crisis of 1998 made a serious blow to the shuttle trade. Many shopkeepers came to bankrupt. Many *chelnoki* ended up with large debts to the Turkish suppliers and could not re-establish their businesses. Nevertheless, despite pessimistic forecasts the shuttle trade as a social and economic phenomenon in general preserved itself and continues to evolve.

On Russian side the absolute preference of cargo forwarders by the *chelnoki* during the transportation of the goods from abroad objectively led to the disappearance of the special (preferential) customs regime that defined the competitive advantages of shuttle imports in the beginning of 1990s. Nevertheless the *chelnoki* maintained their competitiveness in relation to large importing companies and retail trade. Its basis is still low expenses (first of all with regards to effective use of trading space) as well as the energetic reaction to the changes in demand, including policy of flexible price and assortment.

The reflections of these changes in customer demand are the certain shifts in the structure of merchandise purchases by the *chelnoki*. Practically all the respondents in particular stated their urge to buy although more expensive, but more quality products. In general we can apparently argue about the significant increase in the share of higher quality goods in the total volume of shuttle imports.

Shuttle trade in Russia shifts into the regions [provinces] to a higher degree and attempts to integrate itself into the traditional trading network. Particularly, the business of the *chelnoki* who could acquire their trading space is considered to be most successful. However, not many of them could accomplish this. Most prospective in this respect are the small towns and rural areas where the trade infrastructure is extremely underdeveloped, competition is not high, and at the same time the disposable income increased after the crisis.

The recovery of the domestic industry and the sharp decline in the share of barter as a result of ruble devaluation and the collapse of the short-term government Treasury bill market (*GKO*) in August 1998 led to the gradual revival of the

real demand. After the 1998 crisis a resumption in the flow of people into shuttle business took place, especially on the background of stagnation of 1996—1997. However, this flow occurred exceptionally because of the provinces.

A significant factor for the survival of the shuttle business and the maintenance of its competitiveness is the preservation — despite the huge losses from the crisis — of trusting informal relationships with the Turkish suppliers that continued to consign the merchandise on credit to their old partners in exchange for gradual debt clearance accumulated because of earlier merchandise credits.

We can generally conclude that the *chelnoki* gradually entrenched into the traditional trade infrastructure, while bringing the competitive advantages that were initially pertinent to the shuttle business into the Russian trading practices. Virtual refusal of the preferential customs treatment provided during the import of the goods into Russia to real persons opens the opportunities for the civilized and *legal* development of the shuttle trade as a specific form of small business.

As mentioned by our respondents this hard business taught them a lot. Marketing knowledge, communication skills, entrepreneurial flair acquired by them during 1990s could be used in any type of business. However, the effective usage of *innovational potential* of shuttle trade is largely dependant on the government policies, on how favorable the conditions would be for the establishment and functioning of new small enterprises in the area of trade, industry and services.

On the Turkish side our research has proved that Laleli suitcase trade has played and continues to play a crucial role in Turkey's textile industry both in terms of export revenue as well as employment. That is why it is crucial to discuss patterns of formalizing this informal market without losing its dynamism.

Laleli shopkeepers appear to choose informality for two reasons. One is the lacking capacity of the state to respond to the demands of Laleli community. From municipality services to traffic, all shopkeepers have complained about the bad service. Second is the illegal aspect of informal trade which is done for very high profit margins.

The government can fight with the first type of corruption through improving the capacity of the state to provide services such as parking, security, garbage collection, transportation and better coordination of these services.

The second type of corruption, you can fight by providing by giving appropriate set of incentives for businesses to formalize their operations. These measures can include but is not limited to cutting red tape, simplifying export rules and regulations, maybe even free trade zone or a tax cut, more efficient and speedy tax rebates.

Simplifying social security regulations would also help since this would increase eliminate the incentives on the part of shopkeepers to employ people formally. Improving and extending the accommodations and hotel services in the region, improving the regulatory framework for hotels, travel agencies and cargo

services can also help gradually formalize these ties. Coordination of customs regulations and harmonization of trades and tariffs both in Turkey and Russia can also play a significant role in gradual formalization of this informal trade.

Both Russian and Turkish governments should discuss how to maximize the gains from this trade without eliminating its flexible and dynamic aspects. Allowing foreign workers to acquire work permits more easily rather controversial but is crucial for the dynamism of the market. Since informal markets are such a central economic feature of the Black Sea and Caspian Sea region, efforts should concentrate on minimizing the paperwork on both sides.

For the right implementation of policy measures under weak institutional environment characteristic both for Turkey and Russia very important is to find *interested actors*. Usually it is not central or federal government. More likely — municipal and regional governments, which could gain from shuttle trade development — in terms of business activity increase and better tax collection in their areas. But it should be joint activity of local government and business (see Locke, 2001). The goal is creation of better conditions for business and as result — more money for solving of social problems in the region. Possible instruments include invitation of shuttle traders and other interested persons to public discussion on the shuttle trade development in the region, its problems and its externalities (both — positive and negative).

On the base of this discussion can be possible to answer some concrete questions and to develop some concrete public-private projects. For instance:

- Shuttle traders do not enjoy the working conditions at open-air markets — How to improve them? What could invest in such project shuttle traders themselves?
- Shuttle traders would like to buy store but could not — How to make easier the procedures? How to provide credit for such purchases?
- There is often a sharp competition between Turkish and domestic goods at regional market — How to involve the shuttle traders in sales of domestic goods? How to organize the cooperation ties between Turkish and domestic producers (on the base of import of semi-finished products)? Which kinds of domestic products could be sold at Turkish market? What can do local government at political level (to initiate some changes in legislation; to organize presentation and promotion of domestic producers in Turkey; to elaborate partnership agreement with Turkish province or city...).

The same approach is possible for shopkeepers in Laleli and other areas. The advantage of successful shuttle traders and shopkeepers are their *market skills*. And this kind of *knowledge* can be used in other related fields.

At corporate level there is sense to develop integration in different ways — Russian enterprises and shuttle traders; shuttle traders and Russian retail stores; shopkeepers and factories; shopkeepers and hotels; shopkeepers and cargo companies; Turkish factories and Russian travel agencies; Russian enterprises, shuttle traders and Turkish factories etc. Governments in Russia and Turkey could support such integration. But at the same time it is important to save the opportunities for new entry.

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