

The Second Economy: Boon or Hindrance to the Reforms in the First Economy?

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I. Structure of Informal Rights and Relations on the Eve of Perestroika

Mr. Gorbachev's rise to the general-secretaryship of the CPSU made the world privy to a veritable flood of unprecedentedly candid information from the USSR. Coming from all levels and parts of the Soviet polity and society, this information tends to focus on the ills of the Soviet economy, and serves to underpin the twin remedial imperatives of "acceleration" (*uskorenie*) and reform or "restructuring" (*perestroika*).

Not the least among these highly publicized ills — most of which, incidentally, have been long known to specialists — are a variety of self-serving activities that transgress the legal or ethical bounds of socialist life and work, activities that come under such official headings as "non-labor income", "economic crime", "shadow economy" (*tenevaia ekonomika*), bribery, and the like. In the aggregate, these activities add up to a lot of unofficial and often illicit private income and wealth, an underworld of production and trade, a set of black and grey markets, indeed a whole "second economy", which spills over into almost every other realm of social existence.⁽¹⁾

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(1) Some idea of the magnitude of informal (or "private") incomes in the USSR can be grasped from the findings of a questionnaire survey among over 1,000 families of recent Soviet emigres in the United States, conducted by Professor V. G. Treml of Duke University and the present author as part of the "Berkeley-Duke Project on the Second Economy". The data center on 1977 and refer only to urban areas. They have not yet been re-weighted for greater representativeness of the sample in relation to the Soviet urban population. Grouped by region, they also reflect the great spatial variation in the importance of the second economy and informal incomes. The figures presented below refer only to families in which both husband and wife were present and at least one of them was officially employed at the time. The first figure is the mean amount of informal income *per capita* per year, in rubles; the second is the same as percent of mean total (formal and informal) income *per capita* per year; and the third indicates the number of *persons* covered

To be terminologically somewhat more exact, by second economy (SE) we mean the aggregate of economic activities (production, trade, etc.) which meet at least one of the following tests: (a) they are pursued directly for private gain, whether legally or illegally; (b) they are pursued knowingly in contravention of the law in some significant respect(s), whether for private gain or socialist benefit. Accordingly, we refer to the rest of the economy — the official, socialist, formal, legal portion of it — as the first economy (FE). Obviously, the boundary between SE and FE is fuzzy and it bends with the given investigator's concepts and purpose. Third and further economies can be introduced at will. There is no need to be rigid about this.

Personal income derived from SE activity, and from certain informal or illegal activities that are more by way of transfer than production (e.g., bribes, theft), we call informal income (IY). Personal wealth accumulated in consequence of IY we call informally acquired wealth (IAW).

In a given place and time the nature and extent of SE and IY and IY are determined and defined largely by the laws, institutions, and practices of FE. As FE changes by gradual evolution, or by drastic reform or restructuring, SE and IY can be expected to change as well, and from then on to evolve in their own directions. Officially initiated changes in FE may be occasioned by the presence of SE and IY — e.g., to legalize certain activities, and/or to capture certain hidden incomes for the fisc — as in Hungary and, more recently, in the USSR. On the other hand, like all ongoing institutions of production and income — generation, SE, IY, and IAW create powerful vested interests, which in turn may exert substantial conservative influence on social policy and change. These vested interests and their effects are not the same as those deriving from the official

in the given sub-sample.

	<u>r./yr.</u>	<u>%</u>	<u>N</u>
RSFSR and Baltic republics	541;	29.6;	1,051
Belorussia, Moldavia and Ukraine	874;	40.2;	558
Armenia (ethnic Armenians only)	2,065;	64.1;	560
"Europeans" residing in Trans-caucasia and Central Asia	887;	49.7;	488

Since the late 1970s, for reasons partly mentioned in the text, the importance of informal income in relation to formal (official) income seems to have increased, at least until the start of Gorbachev's campaign against "non-labor income" in 1985. For general accounts of the Soviet second economy see Grossman, 1977 & 1979.

Such essentially is the range of legal personal ownership available to individuals. This formal property right is often conditioned in various ways, such as on the individual's or household's proper performance in the socialist sector, or on legal acquisition of the funds with which the objects are purchased. But there are also other valuable rights, which might be termed quasi-property and informal property rights.

By quasi-property-right we mean the right to future streams of legitimate income in cash or kind, such as the (until now) almost guaranteed right to one's actual job (and loafing on the job), to pensions, to highly subsidized housing and food provided (sold) by the state, to nominally free or nearly free medical care and education. These rights (or entitlements) have been socially recognized either *de jure* or in effective usage. The fact that many of the incomes and pensions are very low by any standard, and that the free or cheap goods and services are frequently of very poor quality and/or in short supply, necessitating considerable additional or parallel outlay for the consumer, must be borne in mind, of course.

By informal property right we mean legally unsanctioned and even illegal, yet in reality effective, control over assets for private profit and to future streams of informal/illegal income and consequent wealth. Such informal right may be an expected and accepted by-product of a legitimate job (a very common situation). Indeed, as we have seen, the legitimate job may have been purchased, so that the given informal property right even has a (black) market value — likely discounted for the various attendant risks assumed by the jobholder. Moreover, the seller of the given job may have to purchase *his own* official job, of which the sale of subordinate's jobs (and collecting periodic tribute from them) may be a most valuable illegal attribute, and so on up the hierarchical ladder, generating informal property rights on every rung.

Informal property rights also attach to the control of what we call crypto-private firms, i.e., private businesses with socialist fronts, and true underground private businesses, those without socialist fronts and therefore carefully hidden from view. Crypto-private businesses are common in the USSR. Informal property rights in them and in underground businesses are bought and sold as capital transactions, sometimes with outside private financing. What makes such informal property rights *property rights* is a powerful if brittle combination of (a) customary law of the Soviet underground, nurtured by a philosophy of live-and-let-live, and even with its own adjudication arrangements; (b) the informal networks plus corrupt patronage by officialdom; and (c) widespread corruption all around.

Resting on combinations of this general type, as well as on the failings

(formal, legal) positions, rights privileges, and property holding of individuals and groups, but not unrelated. Indeed, the two may be additive with reference to a given individual or group, inasmuch as official and informal/illegal benefits are often not only enjoyed simultaneously by virtue of an individual's or group's particular job, occupation, ascriptive characteristics, and location, but — hardly surprisingly — tend to reinforce one another. For, in the USSR (and other Soviet-type countries), in contrast to many underdeveloped countries with large informal sectors, the recipients of IY are typically not economically emarginated social elements working in a distinct informal sector, but full-fledged participants in the formal economy.

While many persons work, steal, and earn informally as "loners" or in small, isolated groups, much of this kind of activity and income depends heavily on the actor's participation in one or more horizontal, informal social networks. (To be sure — especially given the bureaucratic formal structure and the economic shortages — the Soviet FE also functions with considerable assistance of connections, exchange of favors, and other aspects of informal networks. Moreover, the two sets of networks intermesh and even coincide. It could hardly be otherwise, underscoring in yet another way the difficulty of drawing sharp lines between SE and FE.) The horizontal networks of the SE not only cut across the bureaucratic and political hierarchies of the formal system, but interlock with that system by dint of numerous vertical patron-client relations. The patron grants his permission, or at least forbearance, and extends some measure of conditional protection. The client pays in cash or kind, and not infrequently buys his way into the particular niche. Indeed, SE operations of even modest size require multiple and periodic pay-offs — to administrative superiors, party functionaries or secretaries, law enforcement personnel, innumerable inspectors and auditors, and diverse actual or potential blackmailers.

The corresponding structure of individuals' property rights is worth nothing. In Soviet law, individuals have the right to own what is called personal (as against private) property, i.e., objects for personal or household use, residences, summer homes, passenger automobile and other passenger vehicles, and simple tools needed to ply a permitted trade or profession. More significantly, one may own tools for small-scale agricultural or gardening activities, insofar as these are permitted, and (within narrow limits) some livestock, fowl, and structures in conjunction with same. Finally, the ownership of currency, a narrow range of financial assets, collector's valuables (e.g., philately, art), and some forms of intangible property copyright, patents, is also allowed.

of the first economy and on wholesale misappropriation and abuse of socialist assets, the second economy and informal property rights flourished during the Brezhnev era. In their wake followed considerable redistribution of real income for many and large illicit fortunes for quite a few.

Another characteristic of the pre-Gorbachev years is the rapid inflation of the currency overhand, especially since 1979. We have addressed its mechanism and hinted at its dimensions elsewhere. (Grossman, 1986)⁽²⁾ More recently, we learned from Gorbachev (in his speech at the June 1987 CC Plenum) that currency in circulation had increased 3.1-fold during the three quinquennia 1971-1985, or 7.8 percent per year. This means that it increased at an annual rate three times those of real GNP or of real consumption (both as computed by the U.S. C.I.A.), and half again as fast as official retail sales at *current* prices. The public's savings deposits increased even faster over the fifteen years — 4.7-fold, or almost 11 percent per year on the average. These data, confirmed by a wealth of circumstantial evidence, leave little doubt that a serious currency overhang confronted the new administration as it took power, at least with reference to the first economy. (In the second economy, where prices are uncontrolled and, therefore, market-clearing, the surfeit of purchasing power brings about open inflation of prices and incomes.)

The monetary overhang may well be one of the main obstacles to a successful economic reform of the official economy under Gorbachev. On one hand, it serves as one of the more convincing political reasons for caution in relaxing price control, thus ensuring that the reform of the first economy will remain little more than a halfway measure for sometime. On the other hand, the currency overhang will tend to help preserve the vigor of the underground economy and the persistence of considerable 'non-labor-incomes', including corruption.

The sections that follow will take up, first, the cognitive and learning impacts of the second economy (Sec. 2); next, the second economy in the perestroika period, i.e., during the transition to a reformed economy (Sec. 3), and second-economy implications of the reformed system insofar as we can discern its outlines at this time (summer 1987) (Sec. 4).

(2) For a characterization of the Brezhnev era in ways germane to this paper, see Millar, 1985.

II. Demonstration Effects and Learning Effects of the Second Economy

It is a commonplace with the populations of the USSR and Eastern Europe, and increasingly so with their political leaders as well, that by its vigor and perdurance the second economy amply demonstrates the existence of major and profound institutional defects in the Soviet-type economic system. Notably, when hard-pressed on the economic front, one government after another has turned to small-scale private activity for assistance: from the NEP in the Soviet Union of the twenties and the legalization of the private peasant plot in the mid-thirties, to domestic measures following the events of 1953 in the GDR and those in 1956 in Poland and Hungary, and on to the encouragement of the "family contract" by Gorbachev. Indeed, there has been this recurring paradox in postwar Eastern Europe: when workers or students demonstrate for change, it is not so much they as the peasants and petty tradesmen and traders that gain economically.

Naturally, the average person tends to associate the shortcomings of the existing order and the lessons of the second economy chiefly with conditions of his own everyday life and work, and with the equitableness — or the inequity — of distribution of material benefits and opportunity around him. There is a growing consensus in the USSR and Eastern Europe that economic betterment and social justice lie in the direction of *some* kind of economic "reform", broadly if vaguely understood as a general institutional and systemic movement in the directions of decentralization and greater or lesser marketization of the socialist sector, legalized privatization or quasi-privatization (e.g., small cooperatives), and tolerated informalization of the smaller-scale activities.

In sum, the very presence of the second economy has been a major argument for the necessity of economic reform. Yet it has prepared the way for economic reform in some more positive and specific senses as well.

(a) Perhaps most importantly, its many negative features notwithstanding, it has served as a living example of an alternative to the official centralized-planned-command system. It has underscored the efficacy of decisions oriented toward profit and market demand, as against hierarchical command and technocratic imperative. Together with this — in the multi-colored markets (Katsenelinboigen's phrase) (Katsenelinboigen, 1977) and in the bartering of supplies among firms — it has no doubt tended to affect the individual's conception of economic value, affirming

market value derived from demand and trade-off as against administratively set, cost-based price. (In our experience, emigrants from the USSR sometimes say "real value" to mean black-market value.) It has tended to monetize both material reality and individual economic thinking. (Lest the reader misunderstand, there is no attempt here to idealize the second economy — merely to bring out the ways in which it may help pave the way to a (more-or-less) marketizing reform.)

(b) The second economy also helps dispel the not uncommon view that generations of Soviet rule have extirpated nearly all private initiative and enterprisingness. Indeed, a student of the phenomenon cannot but be impressed by the constant evidence of widespread enterprise, ingenuity, flexibility, and speed in pursuit of private gain, the more so in that quite frequently these qualities are applied at great personal risk. Illegality does not, of course, necessarily make enterprise or initiative any less such; cf. Adam Smith's (1937: 853) famous words that the smuggler "would have been, in every respect, an excellent citizen, had not the laws of his country made that a crime which nature never meant to be so". Moralizing apart, we may note that many of the second-economy operations are conducted on quite a large scale, sheltered as they are by informal property rights and quasi-property-rights. Examples of such large-scale operations can be found in nearly every branch of the economy, as crypto-private and underground businesses, semi-legal construction gangs (*shabashniki*), pseudo-socialist miners' cooperatives, crypto-private subsidiary establishments of *kolkhozes*. These often deserve being characterized as entrepreneurial in the traditional sense, and not only because they may involve large investment of private (albeit illicitly acquired) capital. Anyone who has looked into, say, the organization of illegal manufacture of blue-jeans in the Soviet Union will probably agree.

The difficult task facing Soviet reformers in trying to harness personal enterprisingness and initiative for legitimate social ends is a two-fold one (i) broadening the currently still very narrow range of legally permitted private activity, i.e., converting some of the informal property rights into formal ones (and preventing the officialdom from reversing the process for its own corrupt ends!), and (ii) harnessing the same personal qualities for the socialist sector itself.

(c) Another important attribute of a modern market economy is that of trust between transactors. In today's commercial and financial practice the word comes first; only later come the reams of legal paper. In Soviet underground practice, in larger-scale transactions along horizontal lines, the word comes both first and last, because nothing can be put on paper for obvious reasons. In our interviews with former participants in this

world, we have often asked how large and highly complicated operations can rest on the spoken word alone. Invariably the answer has been "trust", sometimes followed by "after all, we are businessmen, not apparatchiks". Violent enforcement seems to be rare. Rather, the ultimate sanction for breach of trust is ostracism from the informal network, from the underground world of business, likely followed by loss of the patron's protection as well, and, hence, vulnerability to criminal prosecution for past breaches of the law. The point, however, is that learning to operate on trust — and building up one's own probity — is also a step in the direction of a market economy.

(d) Turning to a rather different theme, we take note of the seeming growth of acquisitive consumerist, and materialist tendencies in the Soviet population during the Brezhnev era. Our authority for the statement is a mass of virtually uncontroverted impressionistic accounts both in the Soviet press and in oral and written emigre reports. This trend interacted with the growth of the second economy, the redistribution of income, and the accumulation of a good deal of new private wealth during the Brezhnev period, as already noted. Whatever can be said about this development from a moral or ideological standpoint, the promise it bears for the marketization of command system is positive. A more acquisitive public makes for a market economy that is more governable by macro- as well as micro-economic instruments, and less in need of administrative (and coercive) means of control.

Such are some of the potential positive contributions of a long-entrenched second economy to a substantial reform of a Soviet-type economy. Weighing in heavily on the opposite side, however, is the aforementioned opposition to reform of the status quo owing to widespread vested interest in the second economy, in its inevitable concomitant, corruption of formal power, and in all other forms of quasi-property-rights and informal property rights.

III. The Second Economy in the Transitional (Perestroika) Period

The transitional period can be said to have begun with the issuance of the anti-alcohol decree of May 1985. (Pravda, May 17, 1985) At this writing, it has been marked by the following major formal measures: the law against 'non-labor incomes' (Pravda, May 1986), the law on "individual labor activity" (Pravda, November 21, 1986), the resolution regarding (non-agricultural) co-operatives (Pravda, January 1987 and *Ekonomicheskaya gazeta*, 1987: No. 9, 11ff; No. 18, 23), "the basic principles of a radical restructuring of managing the [national] economy" (adopted by the CC

Plenum in June 1987), and the law on the state enterprise (confirmed by the Supreme Soviet in June 1987)(Pravda, June 27, 1987; July 1).

It is noteworthy that perestroika's first two measures — those against alcohol and non-labor incomes — were expressly prohibitionist and punitive rather than liberalizing in nature, and very harshly so. The signal that both sent out, a year apart, was that perestroika is not only about the broadening of economic freedom for entities socialist and private, but also about the coercive restriction and containment of the individual's freedom of choice as both consumer and producer, at least in some respects. The latter message was implicitly reinforced by publication of the law on individual labor activity which went only a short distance towards greater permissiveness in this area.

(a) Gorbachev's anti-alcohol campaign is not the first in Soviet history since the abolition of alcohol prohibition in the early years of the Soviet era, but it is by far the most resolute and harsh, and is handled primarily by the police and other administrative means. It addresses a most serious social and economic problem. One can hardly gainsay the campaign's underlying assumption that there will be no real sanitizing of the material, medical, and moral aspects of Soviet society without a sharp reduction in alcoholism and drunkenness. At this writing, over two years since the campaign's inception, the longer-term results are still far from discernible. Lately, there has been much complaint from various Soviet sources, from Gorbachev down, that the campaign is flagging; calls for its re-invigoration are being sounded.

It is not our task here to inquire into the campaign's manifold social aspects. Rather, we focus on the effects on the second economy, and through that on the implications for economic reform. The facts and numbers that follow are courtesy of Professor V.G. Trembl of Duke University, U.S.A., the leading Western authority on the economics of alcohol in the USSR. According to Soviet data, *official* sale of alcoholic beverages, in terms of pure alcohol, fell by about one half between 1984 and 1986. (All comparisons in this section refer to these two years.) This is no mean achievement, of course, aided though it was by steep increases in official prices (68 percent for vodka) and by physical rationing of vodka in some localities. But all observers agree that *consumption* of alcohol declined much less, owing to the sharp increase in home-made alcoholic beverages, especially home-distilled vodka or *samogon*. One leading Soviet authority insists that there was *no* over-all decline in consumption, the whole drop in official alcohol sales being compensated for by the rise in samogon consumption. (G. G. Zaigraev in *Kommunist*, 1987: NO. 11, 37) Professor Trembl does not go so far. He estimates a decrease in absolute alcohol

consumption of about one fourth, still very substantial. His calculations show that in 1986 the consumption of samogon exceeded that of official vodka for the first time ever.

If samogon production is counted as second-economy activity, one consequence of the anti-alcohol campaign has been a considerable rise in informal income on this account. (Note that official prices of the ingredients of samogon, of which the most important is sugar, have not risen, with minor exceptions.) There has also been a considerable rise in black-market sales of both official vodka and samogon, both at increased prices, of some ingredients of samogon, such as yeast, and also sale of places in the now long waiting lines before liquor stores.⁽³⁾

Not the least of the effects, however, has been the implicit rise in the ruble value of remuneration in the second economy. Because such labor is commonly paid not in cash but with vodka, and because gifts of vodka are commonly used to induce labor to perform specific tasks in the first economy as well, the rise in both official and black-market prices of vodka in fact means a rise in the ruble wage of a unit of labor in such cases. This effect at the wage margin, as it were, may eventually, directly and indirectly, exert upward pressure on intra-marginal — and, therefore, average — ruble unit labor costs as well.

Finally, to the extent that the state does not recoup from increased sales of other commodities (including sugar for samogon) or of services to the public the fiscal revenue and industry profits lost on sales of alcohol, there would be a corresponding increase in the currency overhand, with consequences on the second economy and the reform along the lines sketched out above. However, in the event, it appears that the increases in official prices of alcoholic beverages may have brought in enough additional net profit and fiscal revenue per liter to roughly compensate for the reduction

(3) Tremml estimates samogon production in 1986 at 1.0 to 1.3 billion liters of absolute (100%) alcohol. At samogon black-market prices of 12-16 rubles per liter of standard alcohol content (40%), and therefore 30-40 r./l. of absolute alcohol, the gross 'street value' of output comes to 30-52 billion rubles. Compare this with total official retail sales of all goods of 332 bill. r. in 1986. The value added must be quite close to the gross value, for the cost of ingredients (chiefly sugar) is very low, though risk may be a substantial cost component (especially when the product is marketed and not just self-consumed). The sharp rise in the attractiveness of samogon production has stimulated an underground private industry of production of stills (distilling apparatus), some of it within state machine factories (*Sotsialisticheskaia industriia*, August 16, 1987; 4). On the significance of alcohol in general, and samogon in particular, in the USSR and its second economy see Tremml, 1982 and Tremml, 1985.

in sales volume.

(b) The May 1986 law against non-labor income was, of course, aimed directly at the illegal part of the second economy, which is to say at most of it. (Even the peasants' private plots did not escape its sting, as we shall presently see.) Immediately, it raised difficult issues of conceptualization and delimitation. Are the earnings of the truly hard working *shabashnik* construction gangs to be qualified as "non-labor" because of various inevitable illegalities in their methods (e.g., supplies from the black-market)? Or perhaps merely because such earnings are very high by Soviet standards, though often the earnings of millions of state employees who are patently overpaid in relation to their performance? Is not part of their remuneration also non-labor income? Or the interest received from state bonds and the winnings from state lotteries? These and similar issues came to be quickly debated in the press. Needless to say, they have not been resolved.

Enforcement of the law began with much publicity and zeal. Clearly, the relevant local authorities had to show results (the incriminating information had been at hand along), while at higher levels the opportunity was seized to eliminate politically less acceptable officials of large and medium caliber on charges of corruption (usually valid, no doubt). A by-product of this campaign was the demonstration of the extent to which illicit but productive activities had permeated the total economy. The press began writing about the disappearance of various useful and even essential services (e.g., medical services) because the risk of accepting the wonted inducements became prohibitively high. But the biggest outcry surrounded the sudden disappearance of a large part of farm produce from the so-called *kokkhoz* markets (relatively free peasants' markets), and the corresponding surge of prices. Not only did this occur at the height of the summer's bounty, but, paradoxically, the bulk of the produce in these markets originates with the perfectly legal personal plots of collectivized peasants and state-farm workers. Yet the underground was, in fact, heavily involved: "up to" 80 percent of all the produce had been moved to market by bribing the drivers of state-owned trucks (since the peasants are forbidden to own commercial vehicles),⁽⁴⁾ and a high proportion of the produce sold in larger cities was in fact sold by the outlawed middleman.⁽⁵⁾ Both kinds of "criminal" perform useful services from the standpoints of the consumer and the producer alike, and although they are

(4) Figure from deputy procurator-general of the USSR N. Bazhenov, quoted in *Pravda*, July 14, 1986: 3.

(5) Figure and reference to be supplied.

easily spotted, they used to bribe their way to market. But now the heat was on the police, the useful services were cut off, and much of the produce disappeared from the market. In later July 1986, in Khabarovsk, Gorbachev commented on the shockingly high market prices, law enforcement was apparently somewhat relaxed, supplies resumed their flow, and a round was scored for the second economy. The episode is now known in the Soviet press as the "excessive zeal of July [1986]" (*iul'skii peregib*).

(c) According to reliable private information, the law on permitted individual labor activity (ILA) was to be published simultaneously with that against non-labor income, bringing the carrot along with the stick as it were. But it was delayed by six months because of high-level disagreements. What emerged in November 1986 is a very limited advance on earlier legislation, particularly that of 1976 relating to artisans and craftsmen. The 1976 law produced only meager results owing to official hostility, high taxes, and other impediments.

The 1986 law lists some 30 permitted kinds of ILA in the area of goods and services production (not commerce), of which only a few are newly opened for private activity. Among the latter are motor-vehicle repair and the use of personal cars as private taxis, in both cases only legalizing what already had been widespread and long-standing practice. The law provides that activities neither expressly permitted and nor expressly forbidden therein may be legalized at the republic level. (It is under this provision, apparently, that the small *individually* owned eating establishments are being authorized.) But the actual licensing of ILA is left to local authorities; and here may lie a serious snag to the law's success, as explained below.

In addition to retaining a narrow range of permitted activities, the law limits the potential scope of ILA in several other dimensions. Any person who by virtue of age and health is expected to be employed in the socialist sector may engage in ILA only outside the working hours of the official job. (In the past, this kind of restriction has been often circumvented by the purchase of fictitious employment in some socialist enterprise.) Only family members may help (also outside official working hours, of course). Non-family persons may not be employed at all. Either locally set annual license fees (*patenty*) or revenue taxes according to a national scale must be paid; both can be very high. It is promised that material inputs, tools, premises, equipment, transport, etc. will be available, but will they?

The law on ILA went into effect on May 1, 1987. Prior to that, private business provided nearly all of the same goods and services to the public (and, not insignificantly, to the socialist sector, too) mainly through the underground economy. Thus, the law may well result more in legalizing

pre-existing production activity, bringing into the open, than in net additions to it. This in itself may be beneficial to most (if not all) of those concerned, and might allow the treasury to capture tax revenue that now escapes it, apparently a major purpose of the law. However, the co-existence of private, even dwarf-sized, businesses with the Soviet state will hardly be an easy one.

Turning to the resolution on cooperatives of January 1987, we first note that the new regime clearly prefers cooperatives to individual labor activity as a means of mobilizing local enterprise and initiative outside the state sector to provide the locally need goods and services. After all, in the USSR cooperatives are socialist while private business is not. But the impression given by Soviet sources that the cooperatives are a new departure, spawned by the new thinking and pragmatism, is not correct. Non-agricultural producer coops, already traditional in pre-revolutionary Russia, date back to the dawn of the Soviet era, and were re-legitimated in Stalin's day very much for the same reasons and purposes as they are being re-legitimated by Gorbachev. Their membership peaked in 1955 at two million, after which dismantling set in, with final liquidation of all producer coops (with minor exceptions) in 1960. The announced reasons for the liquidation was that they became ready for promotion to a higher organizational form, that of state ownership; many were transformed into or absorbed by state-owned firms. The real reason — as related to us by participants or otherwise knowledgeable emigres in the course of interviews — was that many of them were crypto-private (pseudo-cooperatives), and hotbeds of misappropriation and misuse of socialist (coop) property, sources of private enrichment, and causes of severe corruption of officialdom.⁽⁶⁾ So Khrushchev closed them. Will they be much different under Gorbachev? One wonders.

The new laws regarding ILAs and coops are only months old; definitive judgments of their success are premature. The main theme of the Soviet media has been to praise model instances in operation, but to complain bitterly of the paucity of applications to local authorities and, especially,

(6) As one of our experienced interviewees put it: "It is frightening to think what had been going on in those cooperatives" (*zhut' chto tam tvorilos'*). In fact, similar "frightening" things are still going on, decades after the liquidation of coops in 1960. See, for example, the recent account of the take-over of a considerable portion of gold mining by private businessmen operating through pseudo-cooperatives of miners (miners' coops remained legal) and with the help of large bribes to high officials of the industry; *Sotsialisticheskaiia industriia*, May 13, June 12, June 20, and June 28, 1987.

of the reluctance on the part of local authorities to license them. Their resistance is quite understandable. To them, traditionally and typically, private activity has been fair prey for "squeeze", for sharing in the economic rent inherent in the business. And the bigger rent is to be found in illegal undertakings, which shun the tax collector, ignore price control, and liberally misappropriate socialist assets. Here, protection money is to be raked in; here, graft is to be squeezed out. In other words, what has been the local authorities' informal property right, sometimes actually acquired by purchase, Gorbachev is now devaluing with his anti-corruption campaign and measures to bring underground activity into the open. Little wonder that they drag their feet.

This "antagonistic contradiction" (to use a phrase in context) between Gorbachev's perestroika and his treasury, on one hand, and the self-serving impulses of local authorities, on the other hand, with the would-be entrepreneurs in the middle, may well find its resolution in a compromise: ILAs and coops may indeed be lawfully established in good numbers; the statistics will be gratifying to the partisans of liberalization, but, in many cases the new entities will be partly below and partly above ground. They will provide fronts for crypto-private undertakings, milch cows for corrupt local and industrial authorities, rich but uneasy gold mines for the entrepreneurs, all in the venerable tradition of the Soviet second economy.

4. Reform of the First Economy and the Second Economy.

At this point in time, thanks to the adoption last June of the aforementioned "Basic Principles for a Radical Restructuring..." and "Law on the State Enterprise", and thanks to the many speeches and articles by Gorbachev and his advisors and followers, one sees the general direction in which he intends to proceed toward introducing market forces, if not toward a full-fledged socialist market economy. Certainly, the formal adoption of the two fundamental documents by the Central Committee Plenum and by the Supreme Soviet, respectively, is a significant procedural victory for perestroika. But it is only one battle won, and an early one at that. How fast, how steadfast, with what setbacks, interruption, and detours, and with what detail, the progress towards a reformed Soviet (first) economy will progress, is still unclear. There will be many battles and skirmishes yet, as there will inevitably be innumerable exogenous shocks. It will take many years for the reform process to be — not completed, for such a process never really is — but brought to a point of critically sufficient accomplishment and reasonable stability. What the institutional

state of the economy at that point will be, if the economy ever gets there, is still shrouded in great uncertainty. Will it be a socialist market economy (and how viable would one in any case be)? Or only a halfway solution because this is all Gorbachev (or his successor) wants, or because this is all he can get? Will there be another conservative era on the way? And another Gorbachev after that? Fascinating questions to debate and muse over. At least there should be little doubt that the collective Soviet mind will never be quite the same as before 1985, even if Gorbachev should leave the helm tomorrow.

In the meantime, confusion seems to reign in the economy, because of the enormous turnover of executive and political personnel, the new legislation, the staccato pace of organizational change, and the perestroika itself. So far, perestroika amounts to a blanket injunction not to operate in old ways, but gives little concrete indication how to operate without them. The confusion plays into the hands of the enemies of reform. But it also works to the advantage of the second economy, particularly the underground, accustomed as it is to act quickly and to fill gaps in the first. Hampering the second economy in this regard are the continuing campaign against non-labor incomes and, perhaps more seriously, the impairment of the old architecture of horizontal networks and vertical patron-client ties by dint of the shake-ups of the past two years.

However, time may well be on the side of the underground. Networks and ties are usually rebuilt with time, where there is economic need. And there may be. For a long time yet the reform will be at best in a halfway-house stage, thanks to excessive purchasing power, continuing price control, difficulty to shift from materials allocation to "wholesale trade", non-convertibility of the ruble, and many other reasons. Thus, there will be much disequilibrium for a good time yet, and, hence, much room for underground activity and informal incomes. But perhaps the greatest assurance that the underground will survive is the sheer fact that socialist (state) property will remain within easy grasp, a limitless and constant temptation to improve one's material condition in the old familiar ways. Indeed, illegal activity may be reinforced by Gorbachev's policy to pay unstintingly by results, and hence to allow significantly greater income inequality. No longer need material affluence be concealed, and although its origin is still subject to proof, its legality in principle can disarm the suspicions of others. The rich may be able to get away more easily with their peculations, while the poor may now be forced to seek informal income more avidly. At any rate, a revolution in civic morality cannot yet be around the corner.

But will there be a reverse causal connection, an impact on the course

of the reform from the side of the second economy? This question, perhaps the more interesting one, was already addressed at the beginning of this paper. We saw that by way of certain demonstration and learning effects the second economy may hasten the onset of a marketizing reform, and perhaps also accelerate its progress. And we also saw (Section 2, above) that in terms of individual and group vested interests in a variety of quasi- and informal property rights, the second economy can exert a highly conservative force in support of the existing institutions. Moreover, survival of the underground economy, as just argued, does not guarantee the retention of any individual's or group's informal income. If perestroika does not do much to cut down illicit activity and income, it may still greatly redistribute them. Those who fear losses know what they stand to lose; those who may gain informal income, do not know it with any certainty yet. So the over-all effect of the second economy is still against reforms. Gorbachev's battleground, like the economy itself, is both above and below ground.

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