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THE SECOND ECONOMY IN CONSUMER GOODS AND SERVICES

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The Second Economy in Consumer Goods and Services

by

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THE SECOND ECONOMY IN CONSUMER GOODS AND SERVICES¹

I. Introduction

"The objective of Soviet law in the case of economic crimes is to preserve the rights and procedures of socialist forms of organization." Most Soviet criminologists and economists begin from this premise. Yet for the bulk of the second economy precisely those "socialist forms of organization" have been preserved and used for the purpose of private profit. A franker Soviet expert may say the "object" of the second economy "is to undermine social relations while retaining the form."² But it is perhaps more accurate to assert that only the "form" of socialism exists in the Soviet Union, that the prematurity of the attempt at socialism and the subsequent route of "socialism in one country" have restricted the system to something other than socialism. Moreover, the "social relations" of the Soviet system are precisely the cause of the second economy, rather than being undermined by it. In other words, Soviet-style centralized planning is neither socialist planning nor even effective planning. Since it is not socialist, or democratic planning, the preferences of society (much less of individuals) are not met. Under these conditions incentives for workers to continually check and defend the plan are lacking. As a result,

the plan is not effective--it is violated at all stages of the economy. Violations take either the passive form of low productivity of labor and shoddy work, or the active form of the second economy.

It is the purpose of this essay to examine this "second economy" in the sphere of consumer goods and services (Marx's Department II). Throughout, the objective is to analyze our subject in such a way that the analysis will shed light on the relationship between the second economy and the first. Further, we will discuss the comparability of the second economy to capitalist commodity production in terms of factor supply, ownership and pricing.

II. Structural activities

Soviet analysts do not treat the subject of the second economy explicitly, but the legal literature does discuss individually its components. This is a source that has hardly been tapped in the West. Yet viewed as a whole, legal articles and books provide a way of finding out which activities the experts feel are important, and how important each is relative to the others. Much of the present paper focuses on the Soviet perception of the second economy as revealed in the legal literature. Among questions which stand out the most is the distinction between private activity that takes place at the state or collective enterprise, and that which does not. By way of introduction, a systematic review of the

components of the consumer second economy is possible, using the legal classifications set forth in the criminal codes of the Soviet republics.

In approximate order of importance, the activities undertaken in the consumer second economy are: private enterprise (chastnopredprinimatel'skaia deiatel'nost'), commercial mediation (kommercheskoe posrednichestvo), causing property damage through deception or abuse of trust (prichinenie imushechestvennogo ushcherba putem obmana ili zloupotrebleniia doveriem), speculation (spekuliatsiia), engaging in a handicraft without certification (zaniatie kustarnym promyslom bez registratsionnogo udostovereniia), and engaging in a prohibited trade (zaniatie zapreshchennym promyslom).

Another crime which is intrinsically tied to the second economy but which in itself does not constitute a second economy activity is misappropriation (khishchenie) of state or social property. The relationship of misappropriation to the second economy will become clear in the subsequent text.

Review of the Soviet literature and discussions with Soviet citizens and emigres point to "private enterprise" as the most widespread form of large-scale second economy activity. As in the West, the objective of these activities is the receipt of profits or labor income--in Soviet terms, unearned income. But in the context of Soviet law, to be classified as "private enterprise" an activity must also be

carried out "under the mask" of a state, cooperative, or other socialist enterprise.³ Otherwise, it is simply classed as employment in a handicraft without certification or engaging in a prohibited trade.

The usual forms of private enterprise are organizations (factories, artels, design bureaus); structural subdivisions in existing enterprises (shops, branches, workshops, sections); or producing partly within the plan and partly outside of it.⁴

The first form is generally known as a "pseudo-socialist enterprise," an enterprise which outwardly appears to be socialist. It will, for example, keep an account with the state bank, keep books, pay some taxes, etc. But its real function is to create private profits. The widespread creation of pseudo-socialist enterprises has been called "one of the most socially dangerous types of private enterprise activities."⁵

A private subdivision within the state enterprise is more common, usually in the form of a subsidiary shop. The subsidiary will use the signboard of the parent enterprise, as well as its documents, letterheads, and capital. Often this takes place at collective or state farms. For example, a group of entrepreneurs, by agreement with a series of collective farms, set up a large number of subsidiary departments for production of various industrial goods. The organizers of the shops themselves hired workers, using kolkhoz documents, obtained the materials, and sold the products.

All financial operations were carried out through the bank accounts of the kolkhozes, who were paid 25-35 percent of the sales revenues.⁶

There are two other methods of private enterprise, common especially to everyday services. (1) A state worker renders a service (e.g., auto repair) to someone, but only pays part of the revenue from finished work to the state enterprise ("under the table" markups). (2) Service orders are taken at the socialist enterprise but rendered privately at home. These methods are very important--56 percent of the cases of private enterprises before the courts in the RSFSR come from consumer services.⁷

However, as in all second economy activities there is conflict among Soviet jurists over classification (kvalifikatsiia) of particular instances of private enterprise. Due to inexact legal definition the courts make many mistakes in classifying similar crimes, especially when there is a possibility of two concurrent charges.⁸ The court tends to pick the charge which it considers more "dangerous"--e.g., large-scale misappropriation rather than private enterprise.

To correct this, it has been suggested that the two crimes be delineated according to the source of illegal income. If income comes directly from state losses (selling stolen goods at the state price) the crime is misappropriation. If income comes directly from private efforts (e.g., rendering at home TV repair orders made at a state shop) the charge is

private enterprise.⁹ In most cases there is both a loss to the state, in the form of uncompensated use of capital and materials, and illegal income for private efforts.

The distinction between private enterprise and commercial mediation is also misread by the courts. For example, a man found buyers for furniture produced at a state enterprise. He used state transport to haul the furniture and was charged with private enterprise. The charge was later overturned because he was not acting under the cover of the state transport enterprise (in fact, he paid them for the service). Nor was he involved in producing a good or service in a state firm (the furniture factory).¹⁰ The man was, in fact, a commercial middleman.

Several forms of activity as a middleman are included in the consumer second economy:¹¹

Rendering assistance to citizens in acquiring goods.

Often a middleman knows a wide range of people working in state retail stores and wholesale bases. For a significant sum, he will conclude a sales contract for a consumer who wishes to buy a certain article, most commonly expensive consumer durables (color televisions, freezers).

Rendering assistance to citizens in marketing goods belonging to them. This usually consists of closing sales of agricultural goods and (stolen) building materials. A middleman might be given a minimum selling price for iron roofing tiles, then receive as a fee the difference between

that minimum and the eventual selling price he is able to negotiate.

Rendering assistance to socialist organizations in marketing their goods. Collective farms often pay a fee to middlemen to facilitate sales of their products. This usually means selling agricultural raw materials to factories, but can also include deliveries of goods to retail outlets or even to private consumers. In the case of state enterprises or private enterprises manufacturing consumer goods, a middleman might be employed to locate customers. Some of the "customers" are state trade enterprises which sell the goods on the side for a further profit.

In the three cases above the middleman does not actually sell or buy products, but merely facilitates a deal. However, a middleman might actually purchase goods or sell them. If the mediator actually completes the transactions, he is directly responsible for characteristics of quality. Middlemen sell goods for a fee at flea markets (barakholka, or star"evshchik), especially clothing items and household articles. Larger deals include buying or selling deficit industrial consumer goods and building materials.

Finally, mediators render services to people in concluding other transactions of an economic nature. Usually this is connected with locating housing or helping to get it built.¹²

"Commercial mediation" and "speculation" are often

confused, yet there are quite significant differences, both in form and object. Mediation simply refers to the selling (buying) of a good for another party. The price is sometimes the state price, though admittedly it is usually higher. But there is only one transaction involved, and the mediator is compensated for helping with that transaction. In the case of speculation there are always two distinct transactions: the speculator buys goods and subsequently resells them for a profit. The price is always higher than the original purchase price.¹³ While mediation is sometimes done for an individual, its more characteristic function would be to market goods for a state or private enterprise. There is not any intrinsic connection between the speculator and pseudo-socialist enterprises or subsidiary workshops.

In an interesting court case, a commercial middleman received a commission for selling collective farm apples at a "nonspeculative price" of 60 kopeks per kilogram. He sold them to speculators, who resold them for 80 kopeks.¹⁴

Among second economy activities, the authorities have attacked speculation the most. One of Lenin's first acts after the revolution was to publish his note "On the Fight against Speculation." A decree, "On Speculation," was published 22 July 1918. Today, while speculation is not a very "large" crime in relation to the overall second economy, it is considered "especially dangerous."¹⁵ This is not surprising, as it is a direct threat to planned distribution

and income policy, without serving any productive function.

In most cases purchase and sale are at different places, although sometimes resale takes place in the same locale, roughly at the same time. Large-scale speculators¹⁶ always keep contacts with a few workers in state trade, who know best the situation regarding supply and demand. Often a worker in a supply base is also involved, and gets a cut.

Sometimes trade workers sell goods through a trade organization above the state price ("under the counter" sales). Unless the trade worker previously bought the good this is not speculation, but deception of purchasers. To be deception of purchasers, a sale must "harm" the buyer. Yet "harm" is an optional characteristic of speculation. Restaurant workers buy liquor at a retail store and then resell it in the restaurant at the special (higher) state price, pocketing the difference. This is speculation, yet no harm has come to the buyer, who at any rate would have paid the higher price charged at public catering establishments.

Most second economy activities involve misappropriation (khishchenie) of state or public property. Besides simple theft, misappropriation refers to use of fixed capital without compensation, selling goods and pocketing part or all of the money, and failure to pay state taxes on goods in socialist production or trade. Some misappropriation is petty theft, but up to 50 percent is done by organized groups, and another part by individual private traders.¹⁷ The practice of the

courts to convict on misappropriation rather than lesser crimes means that there is a lot of private enterprise and prohibited enterprise activity "disguised" in Soviet figures as theft.¹⁸ The same holds true for private trade of stolen goods.

III. The consumer second economy vs. commodity production

Sometimes it is assumed that the second economy is a simple manifestation of capitalism within the setting of the Soviet Union, that it is functionally set apart from the planned economy. Yet there are basic structural differences between the second economy and capitalist enterprise-- differences arising from the role the second economy plays vis-à-vis the planned economy. In consumer goods and services these differences involve factor costs and reproduction of the entrepreneurial "class."

Differences between the second economy and the planned economy are apparent. Party ideologists tend to treat private activity (even "non-dangerous" or legal activity) as a "lower form" than socialist enterprise because of the "liquidation" of private ownership of the means of production. It is even common now to assert that private enterprise exists even in developed socialism, both as licensed activity and as illegal activity.¹⁹

Marxian thought restricts private activity under socialism to small-scale production and trade--the private entrepreneur

does not purchase labor power or own the means of production. Yet it is clear that in the Soviet case private production has spread to larger-scale production, and entrepreneurs regularly buy labor power. On the other hand, private entrepreneurs do not generally take "ownership" of the means of production (to do so would violate the socialist form, or cover, of the enterprise). Instead they assert control over the means of production, effectively using them to their own purposes. The difference between ownership and control is important to factor costs and class formation.

The second economy can be differentiated from capitalist production by comparing the components of the production process: cost of materials and fixed capital; cost of labor; and profits.²⁰ In capitalism, of course, the last is the difference between selling price of the product and costs of production. Marxian economists argue a relationship between this formulation and the formula: surplus value = total value - (value of constant capital + value of variable capital).

The Soviet private enterprise has the advantage of reduced fixed capital costs. Free use (i.e., misappropriation) of state-owned fixed capital--machinery, tools, buildings--is characteristic for underground production at state and cooperative enterprises. Planned production in the enterprise must make up for losses in productiveness of capital which result from its use in private production. "Pseudo-socialist"

enterprises need pay only the nominal capital charge introduced in 1965. Whether fixed capital is stolen or a nominal charge is paid, the second economy producer has a cost advantage over the capitalist firm. This is analogous to a transfer of congealed labor power into the profits of the private enterprise, but is revealed as a reduction in its factor costs. There is a tendency, then, for a rise in the profits of the Soviet private enterprise relative to profits in capitalism (depending, of course, on the selling price of the final product). Whenever theft of materials is possible--and court evidence shows it to be common--even more is added to profits.²¹

In services, too, fixed capital is usually "provided" free of charge. Not only do workers use tools belonging to their enterprise, but they also avoid marketing costs when business is diverted from the state enterprise.

Since the means of production are generally diverted from the state, rather than owned privately, a vital characteristic of capitalism is missing from the second economy. With few exceptions private enterprises are not passed on intergenerationally. This is an aspect which analyses regarding the second economy as a reappearance of a Soviet bourgeoisie must explore.

The second economy labor market is affected by the fact that most workers and administrators hold a job in the first economy. Not only does a worker's "official" job satisfy the

legal requirement of being employed, but it commonly provides a worker (or employer) with his second economy opportunity. Michael Marrese asserts (for Hungary) that workers have a great amount of freedom in choosing whether, and in what combination, they provide labor services to the two economies. Thus, "the wage regulation system of the first economy and the market mechanism of the second economy together influence the final distribution of labor services."²² If this is so, not only does the second economy affect the quality and quantity of work in the first economy, but conditions of employment in the first economy create breakdowns of the second economy labor "market." These breakdowns include (1) constraints on workers' decisions in the labor market (barriers to entry and exit) and (2) a seller's market in labor.

First, there sometimes is no clear definition between first and second economy activities, especially when a state or cooperative enterprise produces partly under the plan and partly outside of it. Perhaps a worker will get a bonus for second economy production, but there may be no choice involved.

Second, some trades (e.g., repair of consumer durables, clerking in a retail store) offer more of an opportunity for second economy work than others. There are long waiting lists, for example, of applicants hoping to be accepted into retail-clerk training programs.

Third, different types of activities differ in regard to the worker's position vis-à-vis the means of production. In the second service sector most workers are essentially self-employed and their wages depend on how much work they can perform and at what charge. In production, workers would tend to be hired by a second economy employer, who would pay them a wage for their labor.

The market for second economy labor is in some sense a seller's market, unlike under capitalism. Because of the policy of full employment and the lenient attitude toward shirking in Soviet industry, a worker cannot be expected to work productively in the second economy unless he is well paid (especially given that the purchasing power of extra income is low). There must also be compensation for the risk of being caught by authorities. However, the risk is low for shopfloor workers and probably is a major factor only in administrative positions. Soviet and Western research and journalistic accounts bear out this wage differential between the two economies.²³ Sometimes a pseudo-cooperative situation develops, where all workers of a subsidiary shop share (unequally) in the profits.

Higher labor costs need not raise factor costs faced by the second economy firm, however. Usually some of the costs are paid by the state enterprise. In fact, there are a number of advantages to the state firm in putting private labor on its rolls. Extra labor can be held as a hedge against future

increases in the enterprise output plan (the "ratchet" principle in planning). Similarly, second economy labor within a socialist firm can be used as a reserve for planned production--i.e., to compensate for seasonal production fluctuations (on the farm, for example), to help in periods of "storming." Finally, a larger workforce increases the size of the enterprise incentive fund.

IV. Prices of private consumer goods and services

While costs of production in second economy enterprises are generally much lower than their capitalist and socialized counterparts, prices are very high, raising further the profit margin between revenues and costs. This is due to (1) low supply and incorrect assortment of supply of consumer goods and services in the state sector and (2) low state retail prices.

The reasons for insufficient supply of consumer goods have been discussed elsewhere, so a brief review will be adequate for our purposes. Specific problems include inadequate supply of factors of production to Department II; incentives which neither stimulate total consumer production or correct assortment of goods (the phenomenon of "advantageous" and "disadvantageous" products); insufficient study of consumer demand; lack of use by policy makers of the "mark of quality" as widely in consumer production as in producer goods; and others.

At the same time, prices on consumer goods and services are set at a level that "reflects neither quality parameters or the consumer properties of a product."²⁴ Given supply imbalances, even if prices did reflect the "use value" of a product they would not reflect supply and demand. Still, the Soviets are ideologically correct in their attempts to base prices (and therefore distribution) on social needs rather than demand considerations. However, the success of this policy is precluded in the Soviet Union by inadequate development of the forces of production.

Under these conditions, Soviet consumer price policy is geared at (1) stability, (2) accessibility pricewise of basic goods and services to everyone, (3) "rationalizing" consumption (i.e., directing purchases away from or toward certain goods according to the planner's perception of the social good). Unfortunately, these goals usually conflict either with each other or with conditions of supply and demand.²⁵ So by criterion (2) above, retail prices on housing, basic foodstuffs and books are set below "average socially necessary labor costs" (i.e., they are subsidized). Of course, this conflicts with criterion (3)²⁶ and also creates excess demand (queues, parallel markets, high collective farm market prices). By the same token, we are told, luxury items are priced very high by applying a large turnover tax. Even so, the prices on goods such as automobiles are low enough to encourage a thriving black market.

The overall situation in state trade, then, is such that there is excess demand for the majority of goods. At the same time, some products pile up on the shelf, usually because their quality characteristics are not up to par with consumer demands.²⁷

Excess demand is characterized not merely by the excess income over outlays of the population. It is also tied up in "latent" (skrytyi) demand--unsatisfied demand for certain goods is transferred to purchase of a less desirable good.²⁸ Some of this transfer may be to the second economy, driving prices even higher.

An unquantifiable share of consumer supply (as reported in official statistics) is actually produced and sold through the second economy. A part of the production of pseudo-enterprises and shops will be "hidden" in official consumer supply figures at official prices, although they are actually sold on the side at higher prices.

In sum, the direction and ineffectiveness of Soviet consumer planning result in low supply. At the same time low prices are a social necessity from the point of view of the state. Thus, we expect black market prices to be very high, much in the same way as monopoly prices rise as supply is held back. However, the second economy also benefits from the inability of state firms (providing the bulk of consumer production) to raise prices to take advantage of shortages. No firm or group of firms in capitalism has such control over

other firms.

The scattered data on second economy prices confirm our expectations. High price differentials are almost universal, but a few concrete examples are enlightening (second economy price: state price): fish--5:1; saiga meat--10:1; furs--5:1; books--4-100:1; scarce prescription drug--40:1; imported shoes--3:1.²⁹ In 1978 the markup to get an 8,000 ruble car without waiting was 2,000 rubles.³⁰

The two major exceptions to the rule are gasoline and liquor. The seller pays nothing for gasoline, which is not yet a deficit good, so he is merely undercutting the state price (5:7). Samogon (moonshine) is of lower quality than vodka, and is produced individually at low cost (3:5; interestingly, this corresponds roughly to the price ratio of "poteen" to whiskey in Ireland). Both of these are special cases where competition within the second economy keeps prices low. However, gasoline prices are certain to rise as (1) the Soviet Union experiences an energy shortage and (2) the enforcement campaign against stealing is intensified.

V. Size and distribution of the second economy in Department II

In another paper³¹ I have presented estimates of the size of the second economy for specific consumer goods and services. Professor Gregory Grossman also presents selected estimates, along with an enlightening discussion of quantification problems, in a recent essay.³² Yet most of these estimates are

confined to private production outside of the state sphere (i.e., not including "private enterprise" as defined herein). Though this is unfortunate, it is usually necessary because private enterprise (under the mask of state or collective enterprises) is really much more hidden than "prohibited production."

Vague estimates by knowledgeable emigres of the size of the second economy run from 10 to 50 percent of the first economy.³³ Most Western experts seem to agree with this range, although it is too large to be really meaningful. Some Soviet experts agree as well. A high Gosbank official, using Gosbank data, concludes that 35 to 50 percent of domestic service orders at state enterprises are done "on the side."³⁴ This would mean total private services valued at 3 to 6 billion rubles from "private enterprise" only. Incomes from "non-registered" and "restricted" services would add a great deal to the total. In housing repair, most private trade is sought out door-to-door by "Uncle Vasya" or goes to a known serviceman living in a certain block of flats ("non-registered" trade). If housing repair comprises half of privately rendered everyday services³⁵ then the total could rise to as high as 9 billion rubles or more, about 6 percent of total consumption.³⁶ These estimates are at official prices, but rates are much higher in the second economy. Thus, total income from private rendering of domestic services is even higher. Whatever the exact size, it seems to have been a

rather constant proportion of total services rendered, and there is no reason to believe that it will be reduced. The new constitution takes a more liberal attitude toward private services, though it remains to be seen whether practice will conform.³⁷ Even so, high taxes will continue to keep "Uncle Vasya" underground.

According to subjective accounts by emigres and to Soviet newspapers, private enterprise, such as subsidiary shops at collective farms and private service work at state service enterprises, is one of the most extensive (in terms of output) forms of second economy activity in Department II. A review of Soviet economic and legal literature gives the same impression, as analysts seem to be suspicious of almost every subsidiary enterprise in the country.

While court statistics on particular economic crimes are not generally published, some data on misappropriation are available. We know that misappropriation is fairly equally spread across the second economy activities. Also those guilty of private enterprise and illegal trade are generally tried on the more serious charge of misappropriation whenever possible. So the spread of misappropriation cases by economic sector may indicate the distribution of the second economy among sectors.³⁸

Research of Soviet court cases carried out by the All Union Institute for the Study of Causes and Elaboration of Measures for the Prevention of Crime shows the following:

enterprises of state trade were the source of 21.9 percent of the cases of misappropriation; consumer cooperatives, 13.3; and enterprises of public catering, light industry, and collective and state farms, 16.8. Enterprises in thirteen other sectors made up the remaining 48 percent of cases.³⁹

While the spottiness of detection of economic crimes means these figures should not be overemphasized, they lead to several conclusions. Of the cases involving state trade, cooperative trade, and public catering we are told that almost all involve "under the counter" sales of goods above the state price.⁴⁰ Yet this conflicts with the evidence that only 6 percent of the cases in trade involved insiders--i.e., most of them were from outside, probably shoplifting.⁴¹ Thus, while trade has over 40 percent of the cases of misappropriation, most cases are small-scale, unorganized theft.

In industry, the cases are almost all large-scale misappropriation going toward the production and sale of private enterprise goods.⁴² In this instance, two-thirds (65 percent) of the cases are "inside jobs."⁴³ Thus, industry makes up a smaller proportion of cases (counting heavy industry and subsidiary industries at state and collective farms, less than one-half as many cases as in trade); but in terms of ruble value of misappropriations, the average case in industry is many times larger than in trade. However, even if most second economy activities begin with production (in value terms) they usually also involve trade, since most

illegally produced goods are marketed privately ("na levo" trade, commercial mediation, speculation). These trade activities were not covered by the previous discussion, because they are by nature unconnected with misappropriation.

The significance of the distribution of second economy activities lies in the following: if second economy activities are in production, their effect is on the availability and assortment of consumer goods throughout the economy; but if they are in the sphere of trade, they affect the distribution of goods to the population. Each, in turn, has its meaning regarding the nature of the Soviet "socialist" economy.

The widespread nature of private production under the mask of state enterprise has not been recognized by some Western economists who have estimated the impact of the second economy.⁴⁴ Perhaps most of it is already included in GNP, depending on the accounting procedure for the pseudo-socialist enterprise and where (how) the good is sold. The widespread private rendering of services already mentioned is definitely not included in national income accounts. But whether these activities are or are not included is really not so important for our purposes, for this study is concerned less with the absolute size of Soviet GNP than with the dependence of the Soviet planned economy on the second economy. That there is such a dependence is proven, de facto, by the consistent presence of a large, integrated second economy.

VI. Impact of the second consumer economy on the first

With the introduction of economic accounting at Soviet enterprises, analysts asserted that the second economy would be reduced, since khozraschet "strengthens the personal interest of each worker and employee in the results of the work of the collective as a whole."⁴⁵ Yet this has not been the case, because the enterprise worker does not have adequate "personal interest" in implementing a plan over which he has no control.

The consumer second economy is not merely an encroachment on planned relations of production, however, but also on planned relations of exchange. The complete process is in the following example:

A subsidiary shop is set up at an industrial enterprise to produce women's blouses (private enterprise). The shop is equipped with enterprise machinery (misappropriation) and uses stolen nylon fabric. Workers at the shop are officially employed and paid by the parent enterprise, but also receive a wage premium from the shop's profits. A middleman sells the product for a fee to employees of a state clothing store and other assorted people. A profit is made, on which no taxes are paid. The buyers resell the goods at a higher price (speculation). Many of the state clothing stores also receive official goods originating from the same industrial enterprise. These, too, they sell at a high price, pocketing the difference between the official price and the speculative price.⁴⁶

Here there are a number of examples of economic and social effects of the second economy. The use of state machinery and materials obviously lowers capital formation, since the private enterprise pays neither a direct charge for depreciation or taxes toward expanded reproduction. This has a negative effect on the future production of consumer goods and services (and producer goods, as well). In addition, Soviet experts claim that, if the means of production are actually purchased, private enterprise takes on a character completely of a capitalist type, leading to the private exploitation of labor, which violates the basic principle of socialism.⁴⁷ However, it appears to this author that the difference between control and ownership in this case is purely form rather than substance. If anything, to the extent that an entrepreneur is forced to purchase the means of production, costs are increased and more funds are available to the state for accumulation. But even if capital is purchased, the private enterprise has an advantage over its "counterpart" in capitalism due to the Soviet policy of underpricing most producer goods.

Diversion of materials to the second economy can mean sabotage not only of Soviet productive capacity, but also of product quality. In the example above, nylon fabric may be diverted to private enterprise by shortening the length of blouses in official production, or by leaving out part of the lining in coats.

Labor is also diverted to the second economy at the expense of the first economy. In our example, labor is directly allocated to private enterprise while being paid by the parent state enterprise. The lure of higher wages may draw labor from the state sector, causing damage if it affects those places that are experiencing a labor shortage. In the case of moonlighting (especially in services) the worker's energies are drawn away from his state job, causing a decrease in productivity.

Finally, second economy production obviously distorts the balance of production set forth in the plan. This happens already, within the nonprivate sector, as plans are disaggregated and put into effect. But there is no reason to believe that private enterprise in Department II corrects the distortions caused by ineffective planning, since it is primarily aimed at a profit rather than at social goals. This may be different in the producer good second economy, where factors are widely traded for the purpose of plan fulfillment.

While private and prohibited enterprise is an encroachment of planned relations of production, its profit and price policies violate planned exchange. The same is true of second economy trade in officially produced consumer goods.

As we have seen, profits of second economy activities tend to be high due to cost advantages, uncontrolled prices, and nonpayment of taxes. But in the overwhelming number of

cases no part of profits goes to social consumption (e.g., education, housing subsidies, etc.). Yet those who receive unearned profits enjoy the benefits of social consumption. Likewise, the higher wages of private activities escape taxation.

Not only are second economy incomes uncontrolled, they are largely unearned.⁴⁸ Thus, Soviet analysts correctly state that incomes from private enterprise, from mediation services, and from speculation hardly reflect the quality or quantity of work performed. This not only violates socialist principles of basing distribution on social need, but also the oft-quoted Soviet formula of "to each according to his work."

Another "socialist principle" is violated by moonlighting in the second economy. Radical sociologists argue that free time in capitalism is organized in a manner that improves labor productivity on the job. But under socialism, free time is to be for the "all-round development of the person." Yet second economy activities off the job take up a great deal of the average worker's free time in some trades. Overtime, too, is often used by pseudo-socialist enterprises as a way of covering up private production.

Second economy trade violates planned distribution of consumer goods and services. Goods may be diverted from high priority consumers (from the state's point of view) to others. The second economy raises prices causing direct harm

to low-income receivers, while providing a section of the population with a higher income with which to buy the goods. It exacerbates planned unequal distribution and is therefore in direct violation of socialist principles.

Finally, Soviet experts argue that the second economy encourages "a private enterprise mentality." But it has also been reported that in the state sector workers are no longer interested in the plan--they are "only interested in money . . . only talk about how much money they'll make per bucket, per box, per day."⁴⁹ This being so, a "private enterprise mentality" has arisen from the planned sector, without the help of the second economy. It is our contention that the Soviet worker does not consider the plan "his plan," but it is something passed down from above. Thus, there is no incentive to protect the plan, to protect state property, to protect "socialist distribution." As Montias and Rose-Ackerman have put it, "far from being a 'survival' of capitalism, corruption and illegal entrepreneurship seem to be an inevitable response to the Soviet form of political-economic organization."⁵⁰

Because the Soviet authorities cannot admit the systemic nature of the second economy, their measures to combat it are largely ineffective. Traditional means of fighting private trade are indoctrination and prosecution. On one hand, citizens have faced heavy public relations campaigns to persuade them not to run after private profits. On the other,

law enforcement campaigns have always been important--to mention a few, Lenin's fight against free trade in bread, the 1932 campaign against speculation in mass consumer goods, the 1960 Khrushchev campaign against economic crimes, the creation in 1974 of the "Voluntary People's Guards" (dobrovol'nye narodnye druzhiny).⁵¹ The campaigns have been directed predominantly at the consumer second economy, the most recent example especially geared toward slowing the diversion of goods in transport to the second economy. Western researchers sometimes slough off these measures as totally ineffective, but it is impossible to say how much larger the second economy might have been in their absence.

Other measures are preventive. Attempts to improve consumer supply and salability of supply through changes in enterprise incentives are well documented. There are frequent suggestions for "rationalizing" consumer production and trade. For example, it is suggested that consumer service organizations be allowed more freedom to engage in services which are needed by the public--the list of services these enterprises are allowed to provide does not conform to consumer demands.⁵² While these kinds of measures recognize the existence of supply problems, they do not hit at the systemic heart of these shortcomings.

There is recently an upsurge in measures and recommendations of a preemptive type. It is suggested that the second economy can be eroded if the state becomes involved in some

second economy-type activities, and if others are legalized and regulated. Thus, there was a price rise in July 1979 on some of the most widely speculated consumer goods (cars, furniture, rugs, furs, precious metals).⁵³ The price rise on automobiles averaged 2,000 rubles, exactly the figure quoted (above, p. 18) as the black market markup. A major proponent of such a policy, the economist A. I. Levin, admits that demand will always outrun supply unless there is a consistent policy of raising prices on deficit consumer goods.⁵⁴ Further, he asserts, higher prices coincide with the "socialist" principle of distribution according to work (those who work harder are able to buy more than others).

A variation on the same theme is the proposal to sell some of a deficit good in special stores at a high price, and the rest in state stores at the regular state retail price (chastichnye povysheniia roznichnykh tsen). Those who receive higher incomes would be assured these goods but, at the same time, some of the goods would be left for consumers of average or low income.⁵⁵ A similar measure would be to allow enterprises to produce some of their output on the basis of direct contracts with consumers for an agreed price. Since new and fashionable items are sold at a high price in "personal transactions," it is suggested, why not allow enterprises to sell the same goods at a higher price.⁵⁶

Another "preemptive" measure is the diversion of resources to the production or import of a particular deficit

good. After years of unsuccessful attempts to produce blue jeans internally, the government solicited bids from three U.S. companies on a \$7.5 million project to set up a factory to produce them.⁵⁷ But resource constraints severely limit the use of such a strategy in consumer goods.

Still, most of these measures are aimed solely at price. Since a major source of second economy profits is low factor costs, along with the practice of avoiding taxes, higher prices only hit at one side of the problem. Aside from attempts to improve legal control at the enterprise level, little has been done to stop the gratis use of state-owned factors of production.

VII. Conclusion: future prospects

We know that the second economy in Department II is large, though we don't know its exact size. There is little indication that it has become smaller over the years--on the contrary, the liberalization of Soviet life after Stalin could only have nurtured private enterprise. Some people contend that the second economy is now shrinking as a proportion of the Soviet economy--especially in services, where the second economy is probably largest relative to the planned economy.⁵⁸ Our research does not support this.

The major argument for a relative shrinking of the second economy is improved consumer supply. Yet statistics indicate that production in Department II is still growing at

a slow pace.⁵⁹ The exception is consumer durables production, but expanded output of durables has been beset with chronic quality shortcomings. Though the Tenth Five Year Plan (1976-80) was to achieve a very high consumer growth rate, performance has been very sluggish.

Even were investment and official production in Department II to increase considerably it does not follow that the second economy would be undercut. Since much of private profits come from gratis use of factors a lower "market" price would not drive private tradesmen out of business. On the contrary, easier supply of capital to consumer enterprises might improve the position of the private entrepreneur to divert it to his own use.

In services, expansion of the state network may only mean more shops where servicemen can seek private business. Mere expansion will not necessarily improve performance-- people will continue to prefer private service if it is quicker and of better quality. The rapid growth of consumer durable consumption spurs a concurrent growth in demand for their service--the state sector has not kept up. Likewise, in housing repair it is reported that the second economy share is increasing due to a lack of expansion in state capacity and the poor quality of state service.⁶⁰

Higher state retail prices may undercut speculators, but they will not harm the private producer. Further, there is a retail price limit beyond which the authorities would be

unwilling to go. Some private tradesmen may be induced into the state sector, but taxes will keep many away. Those who do register will continue to withhold income from the state and to cover up private activities. There is likely to be a floor below which reform measures cannot drive the second economy. In other words, because the second economy is a systemic outgrowth of Soviet-style planning, reform-type measures cannot eliminate it. The systemic nature of the second economy is underscored by the results of the present study--i.e., the extent to which private activity takes place within the state enterprise, rather than outside of it (and apart from it). The second economy uses state structures in production, trade, and services while it feeds on the shortcomings of planning. Only a systemic change toward increased workers' control over the planning process can put the second economy out of business.

FOOTNOTES

1. I wish to thank Morris Bornstein for many valuable comments on an earlier draft of the paper. Parts of the paper grew out of discussions with Michael Cox, of Queen's University, Belfast.
2. G. V. Ovchinnikova, "Sotsial'no-ekonomicheskoe sodержanie ob"ekta chastnopredprinimatel'skoi deiatel'nosti," Vestnik Leningradskogo Universiteta, No. 5 (1978), pp. 113-14.
3. For example, a man made wagon wheels and sold them to collective farms and private citizens. A charge of private enterprise was overturned because he was not producing under the auspices of a state enterprise. K. I. Lyskov, "Sudebnaia praktika po delam o chastnopredprinimatel'skoi deiatel'nosti i kommercheskom posrednichestve," pp. 128-39, in E. V. Boldyreva and A. I. Pergament (eds.), Kommentarii sudebnoi praktiki za 1974 god (Moscow: Iuridicheskaiia literatura, 1975), pp. 133-34.
4. Iu. Liapunov, "Khishcheniia sotsialisticheskogo imushchestva i chastnopredprinimatel'skaia deiatel'nost'," Sovetskaia iustitsiia, No. 15 (1974), p. 11.
5. V. Stashis and V. Tatsii, "Otvetstvennost' za chastno-predprinimatel'skuiu deiatel'nost'," Sovetskaia iustitsiia, No. 20 (1978), p. 19.

6. Ibid., p. 19. Most other subsidiary shops that can be classified as private enterprise are in light industry (clothing, shoes, household items) and services. Fewer are involved in producing consumer durables.
7. Iu. Liapunov, "Khishchenie," p. 11.
8. A good example is private instruction. According to a Soviet criminologist, "in theory and in the practice of workers of the organs of the militia, the procurator's office, and the courts there is no unity of opinion on the question of classification of the activities of teachers and instructors who arbitrarily set the rate of payment for instruction . . . in some cases it is classified as private enterprise, in others as causing property damage through deception or abuse of trust." B. Abushakhmin, "Eto ne chastnopredprinimatel'skaia deiatel'nost'," Sovetskaia iustitsiia, No. 20 (1973), pp. 15-16.
9. Iu. Liapunov, "Khishchenie," p. 10.
10. K. I. Lyskov, "Sudebnaia praktika," p. 138. The transport workers in the case could have been charged with private enterprise if they had profited from transporting the goods under the cover of the state enterprise.
11. V. Ia. Tatsii, Ugolovnaia otvetstvennost' za kommercheskoe posrednichestvo (Moscow: Iuridicheskaiia literatura, 1974),

pp. 32-40.

12. A permit to live in Moscow is another item. The total cost of the permit is 5-10,000 rubles (part of it for the middleman, the rest bribes for the appropriate authorities). See, for example, Craig R. Whitney, "Soviet Union: A Land of Pervasive Corruption," New York Times (May 7, 1978), pp. 1, 22.
13. There are occasional instances where a person will buy goods at a very low price and resell them at or below the state price. For example, a man bought gasoline coupons in Moscow and resold them to filling station attendants in the Southern provinces. The attendants subsequently resold them at the state price. A. Kuznetsov, "Downfall of a Gasoline 'King'," Sovetskaia Rossiia (August 29, 1979), p. 4. Abstracted in Current Digest of the Soviet Press, Vol. 31, No. 35 (September 26, 1979), p. 20.
14. See V. Ia. Tatsii, Ugolovnaia otvetstvennost', p. 62. A distinction should be made between "speculative price," which is the price speculators (as well as other private traders and producers) are able to receive, and "speculation" itself.
15. V. Pashkovskii, "Izuchenie i profilaktika spekulatsii," Sovetskaia iustitsiia, No. 1 (1976), p. 21.

16. Court practice is that "large-scale" speculation earns a profit of more than 200 rubles. Speculation must also be "systematic" to be classed as large scale. G. Vol'fman, "Spekulatsiia v vide promysla ili v krupnykh razmerakh," Sovetskaia iustitsiia, No. 20 (1974), p. 24.
17. See V. V. Bratkovskaia, "Nekotorye voprosy uluchsheniia bor'by s khishcheniiami gosudarstvennogo i obshchestvennogo imushchestva," pp. 234-54 in Bor'ba s khishcheniiami gosudarstvennogo i obshchestvennogo imushchestva (Moscow: Iuridicheskaiia literatura, 1971), p. 234.
18. A survey of court cases shows that a very large proportion of cases of theft is tied to "subsidiary" and "pseudo-socialist" production.
19. G. V. Ovchinnikova, "Sotsial'no-ekonomicheskoe sodержanie," p. 114.
20. Here we use the price (exchange) domain rather than the value domain for pragmatic reasons. Though one may recognize the transformation in capitalism from values to prices, it cannot exist in private production in the Soviet Union. Not only are the costs of production totally divorced from value, but so are prices, thus making the concept of surplus value a nonsense under Soviet conditions. For this reason, the discussion is kept in terms of costs and prices. When Soviet economists

- use $c+v+m$ to characterize private enterprise in the Soviet Union they are, as usual, ignoring the differences between value and price. See, for example, G. V. Ovchinnikova, "Sotsial'no-ekonomicheskie sodержanie," pp. 116ff.
21. Part of the savings on gratis use of fixed capital and materials can be eroded in the form of bribes to enterprise and government personnel who allow the factors to be misappropriated. This group of people has been described as the "family circle" by Berliner. See Joseph S. Berliner, Factory and Manager in the USSR (Cambridge, Mass.: Harvard University Press, 1957), pp. 259-63. Though Berliner is describing the second economy in producer goods, the principle is the same for the second economy in Department II.
 22. Michael Marrese, "The Evolution of Wage Regulation in Hungary," Northwestern University Discussion Paper, No. 111 (October 1979), pp. 3-4.
 23. Second economy workers commonly receive incomes in five figures, and administrators sometimes in six figures. See, for example, cases in V. Ia. Tatsii, Ugolovnaia otvetstvennost'. This compares to an average annual non-agricultural wage of about 2,000 rubles.
 24. "Razvitie proizvodstva i trgovli predmetami narodnogo potrebleniia v desiatoi piatiletke (za kruglym stolom

Voprosy ekonomiki)," Voprosy ekonomiki, No. 3 (1977), pp. 29-47. Translated as "The Development of Production and Trade in Consumer Goods in the Fifth Five-Year Plan: A Voprosy Ekonomiki Roundtable Discussion," Problems of Economics, Vol. 20, No. 5 (September 1977), p. 77.

25. While supply and demand are not ignored they are in the final analysis secondary considerations; their "role is by no means determinative." M. V. Kokorev, Tseny na tovary narodnogo potrebleniia (Moscow: Ekonomika, 1978), p. 144.
26. For example, Soviet consumption of bread and potatoes, which are subsidized, is much higher than the government considers "rational." A. I. Levin and A. P. Iarkin, Platzhesposobnyi spros naseleniia (Moscow: Nauka, 1976), p. 278.
27. The value of unwanted goods in state trade stood at 3.8 billion rubles on 1 March 1972; 4.5 billion on 1 October 1973; 4.2 billion on 1 April 1975; I. Konnik, "Proportsional'-nost' v narodnom khoziaistve i denezhnoe obrashchenie," Den'gi i kredit, No. 12 (1976), p. 51. During the same period (the Ninth Five-Year Plan) 5 billion rubles was lost through discounting unwanted goods. A. Khodzhaev, "Problemy udovletvoreniia potrebitel'skogo sprosa," Voprosy ekonomiki, No. 12 (1977), pp. 26-35. Translated as "The Problem of Satisfying Consumer Demand," Problems

- of Economics, Vol. 21, No. 4 (August 1978), p. 74.
28. On latent demand, see A. I. Levin, Prognozirovanie sprosa naseleniia (Moscow: Ekonomika, 1977), p. 101. See also, A. I. Levin and A. P. Iarkin, Platezhnesposobnyi spros, p. 278.
 29. See Dennis O'Hearn, "The Consumer Second Economy--Size and Effects," Soviet Studies (forthcoming).
 30. See, e.g., Craig R. Whitney, "Soviet Union."
 31. Dennis O'Hearn, "The Consumer Second Economy."
 32. Gregory Grossman, "Notes on the Illegal Private Economy and Corruption," pp. 834-55, in Soviet Economy in a Time of Change (A Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States), Vol. 1 (Washington, D.C.: U.S. Government Printing Office, 1979), pp. 847-52.
 33. Zev Katz, "Insights from Emigres and Sociological Studies on the Soviet Union," pp. 87-120, in Soviet Economic Prospects for the Seventies (A Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States) (Washington, D.C.: U.S. Government Printing Office, 1973), p. 90.
 34. The basis of these estimates are the results of Gosbank

"audit-days"--Gosbank officials carry out random audits at service enterprises throughout the country, overseeing how they do their work. The service enterprises respond on these days by rendering all services legally. During audits, receipts at state service enterprises rise 1.5 to 2 times over other days. S. P. Artemov, "Sluzhba byta v desiatoi piatiletke," Den'gi i kredit, No. 12 (1976), p. 23.

35. Gertrude E. Schroeder and Rush V. Greenslade, "On the Measurement of the Second Economy in the USSR," ACES Bulletin, Vol. 21, No. 1 (Spring 1979), p. 12.
36. 1970 CIA estimates would come close to our first estimate for "private enterprise" (i.e., the equivalent of 3.5 billion rubles in 1974). However, the CIA also included private rentals in their calculations.
37. For a review of the attitude of the new constitution toward private trade, see Andreas Tenson, "In Support of Self-Employment of Soviet Citizens," Radio Liberty Research, No. 237 (October 10, 1977).
38. Court statistics, however, tell very little about the absolute size of second economy activities. The large majority of court cases of misappropriation continued more than three years before detection. This indicates that many, perhaps the overwhelming majority of, cases of

misappropriation are never discovered by the authorities.

V. V. Bratkovskaia, "Nekotorye voprosy," p. 235;

L. A. Sergeev, "Nekotorye problemy revizionnogo kontrolya i bor'ba s khishcheniyami sotsialisticheskogo imushchestva," pp. 29-54, in Bor'ba s khishcheniyami, p. 39.

39. V. V. Bratkovskaia, "Nekotorye voprosy," p. 235. The Presidium of the Supreme Court of the USSR began a survey of this distribution only in 1966. For an explanation of the current survey procedure, see M. N. Prokhorova and R. P. Sokolova, "Pokazateli statisticheskoi otchetnosti sudov, kharakterizuiushchie sostoianie bor'by s khishcheniyami sotsialisticheskogo imushchestva," Bor'ba s khishcheniyami, pp. 223-33.
40. V. V. Bratkovskaia, "Nekotorye voprosy," p. 235.
41. M. N. Prokhorova and R. P. Sokolova, "Pokazateli statisticheskoi otchetnosti," p. 229.
42. V. V. Bratkovskaia, "Nekotorye voprosy," p. 235.
43. M. N. Prokhorova and R. P. Sokolova, "Pokazateli statisticheskoi otchetnosti," p. 229. The 35 percent of industrial goods stolen by outsiders may be mainly in the form of theft during transport. Most of this is subsequently sold, especially spare parts.
44. For example, Gertrude E. Schroeder and Rush V. Greenslade,

"On the Measurement," p. 11.

45. B. V. Korbeinikov, "Bor'ba s khishcheniiami v usloviakh osushchestvleniia khoziaistvennoi reformy," pp. 201-22, in Bor'ba s khishcheniiami, p. 208. In a similar vein, another Soviet economist asserts that "independence of enterprises can never have anything in common with 'private initiative' or 'private enterprise.'" F. A. Krumiko, Izuchenye rynka tovarov narodnogo potrebleniia (Moscow: Ekonomika, 1972), p. 14.
46. For a good, detailed account of similar operations, see "The Black Millions," Radio Liberty Research, No. 179 (July 27, 1977). The report includes an explanation of some bookkeeping stunts used by subsidiary enterprises.
47. G. V. Ovchinnikova, "Sotsial'no-ekonomicheskoe sodержanie," p. 118.
48. An exception is the provision of some services, where the serviceman uses his own tools and charges a "fair" price. Still, he makes no contribution from his income to social consumption when he pays no taxes.
49. A. Gusev, "Evil Money and Good Money," Uchitel'skaia gazeta (March 17, 1979), p. 3. Abstracted in Current Digest of the Soviet Press, Vol. 31, No. 18 (May 30, 1979), pp. 13-14.

50. J. M. Montias and Susan Rose-Ackerman, "The Second Economy of the U.S.S.R.: Theoretical Considerations," manuscript, 1979.
51. For a good history of campaigns against speculation in the Soviet period, see G. B. Vittenberg, Otvetstvennost' za spekuliatziiu (Moscow: Gosudarstvennoe izdatel'stvo iuridicheskoi literatury, 1962). On the People's Guards, see V. Ia. Koldin, "Populiarnaia kriminalistika," Novoe v zhizni, nauke, tekhnike: seriia gosudarstvo i pravo, No. 4 (1979).
52. D. Garshin, "Pochemu gasnut 'Nevskie zori,'" Izvestia (July 14, 1979), p. 3.
53. "V gosudarstvennom komitete SSSR po tsenam," Pravda (July 1, 1979), p. 3.
54. A. I. Levin, Sotsial'no-ekonomicheskie problemy razvitiia sprosa naseleniia v SSSR (Moscow: Mysl', 1969), p. 188.
55. A. I. Levin and A. P. Iarkin, Platezhеспoсoбnyi spros, pp. 265-66.
56. "Razvitie proizvodstva," p. 80.
57. UPI (July 5, 1979); reported in Radio Liberty Research, No. 212 (July 9, 1979), p. 3.
58. Schroeder and Greenslade, for example, report that private

services have declined as the state network expanded. Yet their figures relate to registered private services, a very small part of the total. Gertrude E. Schroeder and Rush V. Greenslade, "On the Measurement," p. 17.

59. See, e.g., Rush V. Greenslade, "The Real Gross National Product of the USSR, 1950-1975," pp. 269-300, in Soviet Economy in a New Perspective (A Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States) (Washington, D.C.: U.S. Government Printing Office, 1976).
60. Arkadii Likhachev, "Shabashnik," Literaturnaia gazeta, No. 10 (March 7, 1973), p. 12.