

## Markets, Legal and Illegal\*

In the late nineteenth and early twentieth centuries, when socialist ideas and practices were formed in Russia, it was widely assumed that in a socialist economy products and labour would be exchanged directly for each other without the medium of money. The visible hand of the state would coordinate this direct exchange and maintain equivalence by keeping count of the hours of labour carried out and embodied in different products. This mechanism would give results superior, it was thought, to the invisible hand of the market, for two reasons: first, it would strip away the veil of money behind which the employer exploited the worker under capitalism; second, it would avoid the gluts and shortages, booms and slumps of the market-driven macroeconomy.

Such ideas encountered reality first in the Civil War period of the Russian Revolution (1918-21), and a second time under Stalin's first five-year plan (1928-32). These experiences were highly disorientating. Not only did socialist economic fluctuations prove at least as violent as those under capitalism. In addition, despite the most intense repression markets did not disappear but seemed to flourish despite conditions of illegality. Obvious markets were those for food and simple consumer goods. Behind the scenes, markets also sprang up within the state-owned economy as ministries and firms bargained with each other for supplies and the phenomenon of unofficial purchasing agents sprang up. In fact all countries that experienced socialism developed a wide range of markets, legal, illegal, and in between;

In the case of the Soviet economy Aron Katsenelinboigen classified these markets amusingly as follows. At one extreme were the legal markets, "red" where state stores sold state-produced goods to private consumers at the state price; the "pink" state stores where second-hand goods were exchanged at prices set by the staff; and the "white" collective-farm markets where collective farmers brought their private produce to sell to urban dwellers at prices set by supply and demand. At the other extreme were "black" markets for organized trade in state goods that had been privately bought up at low state prices for resale (known as "speculation"), or stolen; and for private products that were illegal by nature such as narcotics. The black market was the only market that was systematically repressed after Stalin's time. There were also "brown" markets that differed from the black one only in that supply was disorganized; suppliers entered on an individual basis, but if they joined together the market became black. Finally there were "grey" markets for disorganized exchanges of second-hand goods and private services that would have been legal but for the lack of authorization or registration of the transaction. The grey markets were widespread and extremely heterogeneous; the objects traded ranged from ordinary consumer goods to apartments, personal services,

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materials, fuels, spare parts, and other producer goods; state-owned organizations and firms were often heavily involved in grey-market trade. As a result, although grey markets were generally tolerated the transactions in them could also provide evidence of criminal behaviour against almost anybody when it was required.

Such markets had important consequences. They eased the private lives of citizens, met the business needs of managers, earned fees for unofficial agents, made profits for criminals, and undermined the authority of the plan. Although private consumers were active in all markets, the grey markets also permitted a substantial flow of resources away from private consumption into the hands of organizations, a process called “siphoning” that János Kornai identified as a major factor in queues and retail shortages under socialism.

The basic problem of markets under socialism was that the plan could not meet all the requirements of the public and private activities that it defined as legitimate and claimed to support; moreover, most citizens and organizations had further private wants that they wished to satisfy regardless of the lack of legal authority to do so. As time passed the temptation grew for socialist governments to accommodate to these realities by accepting a larger sphere for market relations within the socialist economy, and this gave rise to a long, ultimately fruitless process called “economic reform.” The first proposals for a decentralized socialist market within the state sector to reduce the bureaucratic overload on managers and ministers date from the early 1930s. They would not become officially admissible, however, until the 1960s. In the meantime Stalin maintained the view that, if markets persisted, it was only because the Soviet state had to trade with the collective farm peasantry and with other countries on the world market.

The reasons for the failure of economic reform in the Soviet Union and eastern Europe have been much debated, especially given its success in China. One approach to this problem stresses that investors will not commit entrepreneurial effort or resources to markets that lack contract enforcement mechanisms, for fear that private or government thieves will steal the gains afterwards. The Soviet economy and others like it could not evolve well-functioning markets as long as it was understood that their rulers, or their planning agents, had the power to intervene at any time to correct any results of the market that they did not like. As a result socialist market transactions lacked credible enforcement and the expected return to effort was usually higher in politics than in the market. Markets could develop in the margins of the command system only for goods and services that did not require much long-term investment. If this argument is right, the success of market-driven economic growth in China under Deng Xiao-Ping suggests that the Chinese market economy has developed means of enforcement that are not weakened by the central government’s retention of dictatorial powers. But China-watchers do not agree on how this has been achieved.

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