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## CONTENTS

Summary ....................................................... 1  
Introduction ............................................... 1  
The Pre-Reform Situation ............................... 2  
Statistics ..................................................... 4  
The Effects of Economic Reform ...................... 6  
Inflation ....................................................... 7  
Unemployment ............................................... 10  
New Private Activity ..................................... 12  
Economic Crime ............................................. 14
Black Markets, Economic Crime, and Russian Reform
Michael Alexeev, Clifford Gaddy, and Jim Leitzel

Summary

The Russian economy has been commonly described as "collapsing" for more than five years now. Yet the Russian government continues with economic liberalization. The reason that reform remains a politically acceptable policy is not because of the famed Russian patience under adversity. Rather, it is because the usual description of changes in Russian economic conditions is inaccurate. Things are not as dire as usually portrayed. Much of the evidence of decline, including lower output and higher economic crime, is ambiguous when compared to the pre-reform conditions. These are conditions that are not well-understood because of statistical shortcomings, extensive black markets, and a differing set of economic institutions. The current situation is itself not well-captured in statistics, particularly because of wholesale omission of new, legal and illegal, private activity.

There has been a substantial response to the reforms taken so far -- a response that includes a large increase in private economic activity, much of it informal and "black market." This expanded private economic activity has kept the Russian economy from the long-proclaimed collapse. Reforms remain politically feasible because, while imperfect, they are nevertheless working.
Black Markets, Economic Crime, and Russian Reform

Michael Alexeev, Clifford Gaddy, and Jim Leitzel

Introduction

To many observers, last December’s replacement of the aggressive young reformer Yegor Gaidar by old-style bureaucrat Victor Chernomyrdin as Russian prime minister appeared as the death knell for Russian market-oriented reforms. The conclusion seemed inescapable, given the reported extent of collapse that the Russian economy had endured during Gaidar’s year at the helm. Not only had prices skyrocketed, real earnings dropped, and unemployment risen substantially, but economic crime and even organized criminal activity increased dramatically in 1992. As the new year began, Mr. Chernomyrdin announced his first concrete action to roll back reform by reinstituting price controls on many everyday consumer goods such as milk and bread. One might have expected a collective sigh of relief from the battered Russian population.

But the sequel didn’t follow this script. Within a few days other members of the government began criticizing the price control decision, and on January 18 Mr. Chernomyrdin signed a new decree rescinding his original edict. Meanwhile, the faces of his fellow cabinet members bore an unmistakable resemblance to the Gaidar team — they were largely the same people. Somehow, market-oriented reform keeps its hold, however tenuously, as Moscow’s policy of choice.

How can Russian economic reform continue as a credible policy after the deprivations of the Gaidar era? We believe that an important part of the answer lies in that most discredited of Russian institutions, the black market. Combined with many other quasi-legal, informal economic activities, black markets obscured the true state of the Russian economy before market-oriented reforms, and they continue to conceal the effects of reform
today. Reform remains a viable policy option in Russia because much of the collapse often attributed (both in Russia and the West) to reform never took place.

The Pre-Reform Situation

In theory, in the old Soviet economy, goods were allocated by a central plan, which had the force of law. The outputs of an enterprise, and the inputs (such as raw materials or machines) deemed necessary to produce those outputs, were supposed to be channeled to their "correct" uses by planners in Moscow. This form of allocation applied not only to production but also, less directly, to consumption. Although Soviet consumers were given the nominal freedom to spend their wages and salaries as they liked, the central planners had already decided which items would be available, and at what prices, in the state-owned stores.

The labor market was another area subject to rigid centralized regulations. Full-time employment was mandatory for nearly every able-bodied adult of working age in the old Soviet system. One popular textbook of the Soviet era summed up the official attitude nicely: "While guaranteeing everyone the right to work, socialism also makes labor obligatory for all and makes it compulsory for everyone to participate in socialist production, this being the sacred duty of all members of socialist society, irrespective of their origins, sex, or nationality." And while individuals could generally choose where to work, such factors as the length of the work week and the rate of pay were decided not on an individual basis at the company level, but by central planners. With only minor exceptions, working at more than one job was illegal.

Soviet practice, though, differed dramatically from the planning ideal. Enterprise managers couldn't be sure that they would receive the inputs that the planners promised them -- in fact, they had good reason to be skeptical -- so they turned to tolkachi -- "pushers" or "expediters" -- who plied the country in search of needed supplies, and exchanged favors, bartered goods,
or simply paid bribes to secure the necessary inputs. Enterprises also reduced their reliance on the undependable central supply network by manufacturing their own sub-components themselves, outside of the plan, as they also did with other goods in high demand which they could then barter to other enterprises for inputs, or use to supplement the wages of their workers.

Nor were the planned consumer goods always available at state stores. So, like enterprise managers, consumers frequently turned to black markets to obtain goods that could not readily be found in the state sector, at least without substantial searching and waiting in line. For food, the population could shop in free price markets where the collective farm peasants sold their produce directly. Though the markets themselves were legal, production of the food sold there had benefitted from a large dose of black market activity, such as the diversion of fertilizer, feed, and seed from state farms to private plots or the use of state vehicles to transport the privately produced food to market. But for many other consumer goods, the private markets were completely illegal, and sellers in these markets could be prosecuted for speculation.

Labor market restrictions were likewise violated with abandon. Plant managers adjusted the centrally prescribed work schedules by simply allowing workers to take off for hours at a time. Similarly, they made the rigid, planned pay scales flexible by awarding their workers extra benefits in kind, such as consumer goods, housing, health care, vacation retreats, and kindergartens -- or by turning a blind eye while workers pilfered items of value from the workplace. Theft of materials by state-enterprise employees was so prevalent that surveys revealed little opprobrium was attached to it by Russians (although theft from private individuals was not similarly condoned).

The ban on multiple jobholding notwithstanding, sub rosa moonlighting was massive. In the cities of Soviet Russia, one of every four adults engaged in some form of secondary work outside the official workplace. Indeed, by the late 1970s the "official"
state-sector job had for many people become nothing more than a convenient cover for their true source of livelihood -- a second, informal job. State sector jobs were evaluated by workers not only on their own merits but also on the basis of the black market earning opportunities that they presented. Given the choice between two jobs at different official pay levels, the Russian might well choose the lower-paying job, if it offered time to pursue more profitable private activities. In extreme cases, state-sector jobs that had particularly lucrative opportunities for side-earnings might themselves be "purchased," by bribing the requisite officials.

The gap between low official wages and high black market wages grew to ridiculous proportions, as illustrated by an early 1980s incident in Moscow. A gasoline station attendant who had been supplementing his income through side sales of state gasoline at free market prices was apprehended by the police -- not because anyone caught him in the act, but because he failed to pick up his official weekly pay for eight weeks in a row. His explanation: it would have cost him too much valuable time to stop by the city pay office to collect such a paltry sum! Nor was his situation unique. On days when special observers were sent to supervise the activities of providers of services (such as hairdressers), reported activity would often double. The reason, apparently, was that on the supervised days the service providers couldn't so easily divert their transactions into private, black market deals.

Statistics

One of the consequences of widespread black markets and informal activity in the Soviet Union was a severely distorted picture of the economy as seen through official statistics. Those statistics tended to overreport production of the goods that the planners ordered to be produced -- managers and workers would exaggerate output in order to meet the plan and earn their bonuses -- while the statistics underreported the goods and
services produced informally. (These were the goods that probably reflected what people really wanted to consume, as opposed to the goods that the planners deemed appropriate.) With individuals engaging in so much surreptitious economic activity, and with the plethora of non-wage forms of compensation such as subsidized housing or the implicitly sanctioned theft of work time, official income statistics also meant little.

Particularly severe statistical distortions arose from the nature of Soviet prices. Within the planned sector, prices were "passive." While inputs and outputs did have official prices attached to them, these prices were largely meaningless, since resources were allocated by planner decisions — at least officially — and not by markets. Statistics on economic output in monetary terms were based on these fixed prices, rendering such statistics largely meaningless as well.

For consumers, too, official prices were not their only concern in procuring goods from the state sector. Rather, Soviet citizens generally had to comb the city for scarce goods, and then wait in line when they came across them. (Economists call this method of allocating goods "queue rationing.") In many cases, the state-controlled price did not mean much at all to the shopper; rather, the time required to stand in line was the more pressing concern.

Queue-rationing means that a relevant price index cannot be based solely on the official prices of goods; it must also incorporate the value of the time required to make the purchase, which varies among individual shoppers. Economists value this time by looking at its alternative uses. For a retiree without good opportunities for earnings from work (possibly in the informal, black economy), time is relatively cheap, whereas for a high-earning entrepreneur, time is expensive. And for those individuals in the old system who had privileged access to goods without having to wait in line — Communist Party bosses, for example — the relevant price index would be altogether different. Not only could such individuals avoid waiting in line;
the special stores available to them often had higher quality goods at lower official prices than in the normal state stores.

Purposeful misreporting, fixed prices, queue-rationing, hidden or privileged channels of access to goods, and extensive black markets -- all this implies that pre-reform Soviet statistics are extremely difficult to interpret, whether they be measures of economy-wide output like gross national product (a statistic that the Soviet Union did not calculate at all until shortly before its demise), price indices like the U.S. consumer price index, or measures of wages and salaries earned by workers.

The Effects of Economic Reform

The issue of statistical reliability remains a thorny problem for evaluating the current economic situation. Most accounts of the current state of the Russian economy are quite harrowing. Official statistics report that industrial production in 1992 was down some 20% from the previous year, that real wages fell by over 30% and that inflation was close to 2000%. These are just some of the "lowlights" in a succession of statistics that presumably document the Russian decline.

Russian reality, however, belies the reported figures and dire accounts. Despite the almost incomprehensible amount of inflation that has taken place in Russia, and the many forms of economic dislocation, we believe that there is remarkably little evidence that average Russian living standards have fallen precipitously during the reform period. Moreover, careful analysis shows that many of the difficulties that Russia has encountered in this period result not from economic reform, but just the opposite: from a failure to pursue reform vigorously enough. Bad economic policies, particularly those that can be characterized as partial (or anti-) reform measures, have combined with a set of largely unrelated factors such as civil unrest among the former republics of the Soviet Union, disruptions in trade among those republics (and with the nations of the old Soviet bloc), and a relative decline in world oil
prices, to produce a uniquely unfavorable environment for the Russian economy. What is perhaps most remarkable is that even these negative factors have not caused a dramatic collapse of the Russian economy.

Why, then, have so many observers painted a version of the Russian economy so at odds with reality? There are many reasons, but certainly the major difficulty lies in misleading statistics. We have already discussed the unreliability of Soviet statistics in the pre-reform period, thanks to black markets, informal economic activity, and institutional factors such as fixed prices. During an economic transition, statistics become even more questionable.

When an economy moves from a centrally-planned system to a market order, some of the measures of economic activity that we in the West take for granted assume entirely new meanings. Just as religious and nationalist sentiment existed in the former Soviet Union, but were not permitted open expression until the recent political liberalization, economic phenomena such as inflation, unemployment, and government budget deficits existed but were hidden under central planning. Economic liberalization has not created them, but it has brought them into the open. Their new visibility is now being captured by statistics that in the past ignored the concealed versions of these phenomena.

Inflation

Consider the direct effect of price liberalization on inflation. In the pre-reform system, with fixed official prices, Soviet price indices remained constant year after year. Inflation, according to those indices, was close to zero. Nonetheless, inflation did exist. It was simply that it did not manifest itself in the form of higher prices but in the form of shortages of goods in the state sector, declining quality of goods, longer lines where goods were available, and higher prices on the parallel, "black" markets. All these phenomena were evidence of "repressed" inflation. As price controls were lifted...
in the new Russian economy, this already-existing -- but hidden -- inflation suddenly emerged and entered into the price indices. The repressed inflation became open. Thus, the nearly 300% rate of measured inflation immediately following the Gaidar partial price liberalization of January 2, 1992, is misleading. In fact, black market prices didn't go up when state sector prices were liberalized. The rise in official price indices was simply reflecting the repressed inflation that had previously occurred, but could not be measured until the repressed inflation became open.

Inappropriate price indices have led to other spurious statistics. For 1991, official statistics claimed that real wages in Russia had risen by 38%. (The real wage is a worker's monetary wage adjusted to account for inflation; thus real wage statistics are designed to serve as a measure of the purchasing power of wages.) Yet it was clear that workers could in no sense feel themselves 38% "richer" in that final year of Soviet power. The reason for the distortion is that the official price index did not capture the increased repressed inflation during perestroika. Since the old statistics ignored most of inflation, this meant that every time nominal wages were increased, real earnings were also assumed to have risen. Thus, the apparent real wage increase during the Gorbachev era was mythical.

But the problem doesn't stop here. In 1992 the statistics claim that real wages declined by over 30%. Yet this decrease is as spurious as the earlier purported increase. The reason is that this time, the price index used to deflate nominal wages included the switch from pre-existing repressed inflation to open inflation, as though it were new inflation. In effect, then, the entire burden of inflation since 1985 was being placed on 1992 alone -- and being incorrectly attributed to Gaidar's reforms!

The preceding discussion is not to suggest that there has been no real inflation in the reform era. There has been plenty of inflation, of both the repressed and the open varieties. Our point is that this new inflation is emphatically not due to
reform. On the contrary, it can be traced to the government's unwillingness to embrace the full package of reform measures. The Russian government, mainly out of fear of provoking open unemployment, has yet to force its state-owned enterprises to change their behavior -- that is, to either start producing goods that the population really wants -- or to shut down. Rather, these enterprises are being kept afloat by state subsidies, which in turn fuel a growing government budget deficit. Since this deficit is covered not by borrowing (as is generally the case with the U.S. government budget deficit) but by printing money, there has been galloping inflation during the transition.

Russia would clearly be better off with a more manageable inflation rate, if only to reduce the enormous uncertainty that exists about the future of the Russian economy. Yet, as bad as inflation is, the negative consequences of Russia's high inflation are usually overstated. So far, the most noticeable impact of inflation in Russia has been its role in redistributing income: while some people have become very rich, many others have lost the little wealth they had. Older people who had managed to put away a few thousand rubles, for example, have seen their retirement savings rendered nearly worthless over the past couple of years. (The average official monthly wage in Russia in 1990 was around 300 rubles; now, it is nearly thirty times that amount.) But for the majority of Russian wage-earners, inflation has had a much less dramatic impact. Most of the income received by the typical Russian household has in one way or another been protected against inflation. Russians, even those who live in large cities, are producing a large proportion of their food themselves. Outside the metropolises of Moscow and St. Petersburg, nearly every Russian family has its own small garden plot. And in these small cities and towns, well over half of all food consumed is self-produced. At the workplace, a substantial amount of compensation is provided in the form of goods or services rather than cash. It has been estimated that Russian workers receive more compensation in the form of in-kind payments
(food, housing, day-care, medical care) from their enterprises than in cash rubles. Housing costs, in particular, are an almost non-existent budget item for most Russians. A typical family, even in Moscow, today pays less than 1% of the family's official income -- real income is much higher -- for rent. (For comparison, the average family in Washington, D.C., pays 23% of its income for housing.)

Unemployment

Inflation is not the only phenomenon in the Russian economy that has been distorted by movement from a repressed to an open version during reform. Consider unemployment. From October 1930 to July 1991 official unemployment did not exist in the Soviet Union. Nevertheless, there was plenty of repressed unemployment, which took various forms. First, there was the inevitable occurrence of "frictional" unemployment: some 2% of workers were generally out of work because they had quit or been fired from a previous job, or were just entering the workforce. More important was the phenomenon of overstaffing, which at many workplaces reached rates of 20%, or 30% or more. For this army of surplus workers, wages were the economic equivalent of unemployment compensation: payments awarded to individuals who were making no contribution to production. But perhaps the most widespread and serious form of repressed unemployment consisted of those Russians who worked in enterprises that were making more-or-less worthless output. Here it didn't matter how hard the individual worker did or did not work; the effect was zero (or even negative, in cases when workers were simultaneously wasting other inputs that could have been put to more productive uses). Once again, workers were getting paid without making valuable contributions to national output.

Even today, open unemployment remains extremely low in Russia. But just as price liberalization has turned repressed inflation into the open variety, consistent pursuit of reform will eventually convert Russia's repressed unemployment into Western-style open unemployment. Freeing of prices and refusal to
subsidize loss-making firms will force firms to cut back on overstaffing and cause loss-making firms to shut down entirely. However, it is important to note that the rise in open unemployment need not be any more costly to the Russian economy than was the previous repressed unemployment, even if the unemployed workers are paid the same in unemployment benefits as they received in wages. The underlying reality, that such workers are being paid while not making contributions to valuable outputs, remains unchanged.

Lack of consistency in pursuing reform, though, can create new costs in the employment realm. Creation of an explicit social safety net has to be an integral part of the reform package, in order to protect the worse-off members of society. (The previous social safety net was implicit, hidden in the full-employment policy, the provision of goods through the workplace, and low fixed prices for everyday consumer goods. This system is collapsing during the economic transition.) Without a secure unemployment compensation system, workers who lose their jobs and have a difficult time finding new jobs face severe deprivations.

A second, and possibly more subtle, cost of partial reform may arise from inconsistent price liberalization. If some prices remain fixed, then the wrong firms may shut down. For example, if the price of coal is fixed at a low level, coal mines will be unprofitable and be forced to close, even if they might be profitable with free prices. Meanwhile, other industries which benefit from the low price of coal may appear to be profitable, although under a free-price regime they would actually lose money. Thus partial price liberalization is dangerous when combined with an ending of subsidies to loss-making enterprises.

Like increases in measured inflation and unemployment, the decrease in measured GNP does not present unambiguous evidence of economic deterioration. Once again, the analysis is complicated by a distorted picture of the pre-reform situation. In earlier years the official production statistics included huge amounts of economically worthless output — even if we ignore the issue of
military production -- as well as other, potentially valuable output that was produced but then wasted. Neither category contributed to Russian living standards. Falling output figures alone are therefore not a sign of collapse. In fact, any successful transition will probably require a drop in useless industrial output. A decline in military production, which represented a huge proportion of total industrial output, is largely to be welcomed.

New Private Activity

One of the most serious problems with Russian economic statistics today is their failure to capture much of the new private activity. Throughout Russia, parts of enterprises have been spontaneously or legally privatized. This process has partially brought the profit motive to even some of the huge industrial enterprises, which are often adjusting their product mix at the margin to produce consumer goods that are in high demand. Private retail trade, as exemplified by the explosion of small kiosks on Moscow streets, is also booming -- a boom that is very beneficial to living standards, as the dearth of such trade was one of the most glaring deficiencies of the planned system. Also, city dwellers have received greatly expanded access to country land for both dachas (summer cottages) and private agricultural plots, and the result is an upsurge in private housing construction and private food production. Virtually none of this new private activity is accounted for in the official statistics, which were originally designed to report information on a centrally-planned economy. Even if statistical collection were to improve, it is likely that a good deal of this new private activity would not be counted, since tax evasion leads people to hide their participation in the private economy.

Misleading statistics have tended to result in overly negative assessments of Russian economic reforms. But there are other factors that contribute to exaggerated perceptions of economic decline. Prior to glasnost, nearly all unfavorable
economic or social information was taboo; it was "repressed." To the extent that open reporting of previously-existing negative conditions, such as the low living standards in Russia relative to the U.S., is mistaken for a deterioration in the conditions themselves, the transition gets blamed for the shortcomings of the old regime.

Another condition which creates negative attitudes towards reform is the nature of redistribution within an economy. Whether that redistribution is caused by market reforms, as in Russia, or by, say, tax policy -- as in Western countries -- the political effects are often negative, owing to asymmetry in the way the "winners" and the "losers" of a redistributional situation react. Those who feel they are being disadvantaged are more prone to protest. Those who gain by the reforms are simply too busy taking advantage of their new opportunities. Reports of the discontent of the first group tend to outweigh the descriptions of the latter group, and this will then tend to create the perception of more widespread decline.

Redistribution is even more of an issue in Russia because it is happening not only on the individual level, but on a regional level as well. The two largest cities in Russia, Moscow and St. Petersburg, were traditionally better supplied with food and other goods within the official state distribution system than other regions of the former Soviet Union. As the state distribution system has diminished in importance in recent years, the metropolises' priority standing has been undermined. Residents of Moscow and St. Petersburg have therefore found their economic standing, relative to their fellow citizens, falling. (In some cases, of course, their absolute standard of living has fallen as well.) Since the vast majority of Western news reports from within the borders of the old Soviet Union emanate from Moscow, the complaints of that city's citizens have been widely reported, and are extrapolated as being representative of the country as a whole.
Economic Crime

Repressed versus open phenomena, the dangers of partial reform, the unreliability of statistics during a transition, and the tendency to confuse openness in reporting negative phenomena with an actual deterioration of the economy: these can all be further illustrated by the case of economic crime. Black markets and economic crime are fellow travelers. Every black market transaction is by definition illegal, and most economic crimes have a connection to black market activities.

Official Russian statistics show a precipitous rise in economic crime during the period of economic reform. Between 1985 -- the year of Gorbachev's accession to power -- and 1992, the number of all recorded crimes, both economic and non-economic, rose by over 60%. The incidence of theft of state property more than doubled and the number of crimes against personal property increased by a factor of 2.5. Particularly worrisome is the apparent rise of organized crime. The Russian press has reported that the Ministry of Internal Affairs (the "militia," or police) has information on about 3,000 "organized criminal structures" on Russian territory, a number which presumably represents a substantial increase over the pre-reform period.

We have seen how the transition from one set of institutions to another makes it very difficult to evaluate the statistical data in many areas of the Russian economy. The problems are similar in measuring trends in economic crime. To begin with, many old laws have been revoked or changed, and many new laws have been adopted. Actions considered to be illegal only a few months ago are now encouraged by the authorities. For instance, the private re-selling of goods for profit -- earlier labeled as the crime of "speculation" -- has become a lawful and increasingly accepted form of entrepreneurship. On the other hand, some actions have only relatively recently been criminalized. Prostitution is a case in point. Marxist theory held that since prostitution is a social ill arising from capitalist exploitation, it should disappear in a socialist
state. Correspondingly, under the old Soviet regime, not only were there no statistics on prostitution; there was not even a law against it — that would be to admit even the theoretical possibility of such a phenomenon under socialism! With the advent of glasnost', the phenomenon could be acknowledged. Laws were passed to combat it, and it began to be recorded in the statistics.

Yet, even in cases where the criminal nature of an activity was never in question, collection of statistics was haphazard. The police in the former USSR operated under a requirement that 95% of all reported crimes were to be cleared. (The police had a plan to fulfill, too!.) Naturally, this requirement put strong pressure on the police to underreport difficult-to-solve crimes. Moreover, it is highly probable that the overwhelming majority of economic crimes such as speculation were never reported to the police. For example, in the 1980s speculation constituted less than 2% of all reported crimes. In 1985 official statistics listed more rapes and premeditated murders than cases of speculation. In reality, speculation was considerably more widespread than the official statistics would allow. Every time a salesperson sold a good "through the back door" at a markup from the official price, a crime of speculation was committed. Virtually every transaction at the many Soviet tolkuchki (flea markets) constituted speculation.

Perhaps even more common than speculation was the theft of state property. Almost 500,000 such thefts were reported in 1991. Even this number, however, grossly underestimates the true incidence of theft of state property, particularly if we take into account "petty" theft. Only 30,700 petty thefts of state and public property were reported, compared to 452,000 large thefts. Clearly, the overwhelming majority of cases of small-scale theft went unrecorded. Another economic crime where the published numbers are untenable is "defrauding of customers," which reportedly occurred only slightly more often than murder. Offenses falling under the heading of "violations of plan
discipline," such as padding output records or wage rosters, were also largely ignored by official statistics. Adding to the likely underreporting of economic crimes was the indifference of the Russian population to the existence of these "crimes." In short, the amount of economic criminal activity in the old system was repressed in the official statistics -- and, it should be noted, was repressed in the media as well.

Most economic crimes are likely to go unreported nowadays as well. Recent reforms, however, have legalized some formerly common crimes, and significantly limited the scope of others. Plan discipline cannot be violated in the absence of a plan; speculation is now criminal only with respect to trade in a small list of goods (narcotics, weapons, etc.); and the opportunity to steal state property is being constantly diminished by privatization. (Private property can also be stolen, of course, but it is presumably better guarded, and theft from private individuals is not socially acceptable.)

Simultaneously, though, economic reforms have generated new types of crimes. In 1992, one of the hottest selling items at the thousands of small booktables on Moscow streets was a pamphlet entitled "How to Avoid Large Russian Taxes." Tax evasion has become one of the most common economic crimes in today's Russia. These are by definition new crimes, since many of the taxes that are now routinely dodged by individuals and by firms did not exist prior to 1992. But it cannot be determined how common such new crimes are in comparison with the actual amount of pre-reform economic crime. Given the radical relaxation of legal restrictions on individual economic activities, the elimination of the law of the state plan, and the severe problems in interpreting the official statistics on economic crime, it is quite plausible that the incidence of economic crime has actually decreased during reform, despite the official statistics.

Although the perceived jump in economic crime is probably exaggerated, it is important to acknowledge that there has been a definite increase in some forms of crime. But, once again, we
would place the blame not on reform, but on partial reform, on failure to implement full reform. Perhaps the most important impact of partial reform on economic crime derives from the continuing legal obstacles to conducting private business. Various private economic activities, while permitted in principle, often require a license issued by the local government. The procedures for obtaining a license are sufficiently nebulous that local officials can solicit bribes for issuing licenses. Licenses are also required to export or import most goods, and not surprisingly, there are numerous press reports about bribes to federal officials in charge of these licenses. In general, the Russian economy is enmeshed in an extremely complex web of laws, decrees, instructions, and rules, often in contradiction with each other. This web provides fertile soil for bribe-taking and influence-peddling.

Excessive regulations and the attempts of local government to control entrepreneurs also contribute to organized crime. More often than not, private businesses are compelled to break the law in order to operate at all. And, because they themselves are operating illegally, entrepreneurs are unlikely to ask the state for protection from extortionists — just as illegal bookies in the West cannot seek police protection from organized crime. Even a legally-operating entrepreneur cannot easily turn to the police, since the police are often in the private employ of organized crime. As a result, protection rackets appear to be one of the fastest-growing types of economic crime in Russia.

It is thus difficult to give a definite answer to the question of whether or not organized crime has increased in Russia during the reform period. But on balance we believe that the answer is 'no'. After all, the traditional Soviet system of government also bore the marks of a criminal organization — in repressed form, of course. True, many private entrepreneurs in today's Russia have to pay off criminal syndicates. But under the old system, entrepreneurs had to pay off Soviet state and
Communist party officials. Moreover, these officials sometimes headed illegal operations themselves, using the power of the state to suppress competition. (Since any competition was illegal, selective police enforcement could maintain the monopoly of officialdom.) In the Soviet era, the control of the underground economy by the corrupt Communist elite usually did not require street violence. If a black marketeer did not pay the requisite tribute, he would lose the protection of the local officials and go to jail. Since the power of the Soviet “mafia” — a common term in Russia which long predates the reforms of the 1980s — was so obvious and overwhelming, virtually no one dared to challenge its control, and the implied threats of physical violence or prison rarely had to be carried out.

This state-sponsored black market was a vast organized criminal network. One of the most profound effects of recent political and economic reforms has been to eliminate the monopoly position of the Soviet state as the ultimate racketeer. With such a rich prize as the underground economy of a vast nation at stake, the ensuing competition among criminal groups to control as much as possible of the old and new black markets has predictably resulted in gangland-style violence. Ironically, then, despite the talk of a rise of organized crime in reform-era Russia, the perceived increase in organized crime activity is, in fact, a consequence of its relatively disorganized nature when compared to the stable pre-reform Communist party kleptocracy.

The overt street violence currently occurring in Russia is unsettling, to say the least. Entrepreneurs have to pay off racketeers or make other private security arrangements; otherwise, they or their families could meet with violence. In addition, fear of racketeers surely prevents some potentially successful entrepreneurs from starting up businesses, and valuable state and private resources are devoted to efforts to carry out, protect against, or prevent criminal activities.

Yet, as negative as this picture of Russian crime is, things may not be as bleak as they seem, at least in relation to the old
system. In the pre-reform USSR, opening a business was even more difficult. Entrepreneurs operating on any appreciable scale had to pay off state officials and police to obtain protection for their operations. If anything, the established monopoly position of the state in the protection business resulted in higher costs for the entrepreneurs and their customers.

Indeed, the peculiar nature of Russia's recent past and current situation is such that today's black markets and powerful criminal organizations even have some positive aspects. Criminal economic activities can actually serve to promote marketization of the Russian economy. In view of the mass of state controls that still weigh heavily on society and individuals, informal economic activities -- which often happen to be illegal -- may provide the only workable course of action for the Russian citizen. For example, bribes paid to government officials allow entrepreneurs to find their way around some particularly onerous regulations. Theft of state property may actually help allocate the stolen resources better than the state could. Even the racketeers who extort protection money may at the same time facilitate a certain degree of stability and contract enforcement which the state has not yet been ready to provide.

Naturally, we are not advocating crime, but in a woefully inefficient formal economic system, some economic crimes possess socially redeeming features. Hopefully, this will be a temporary state of affairs. As reform proceeds, we believe that two factors will help to reduce the scope for organized crime. First, a more liberal climate for legal business will allow entrepreneurs to operate within the law, and hence make them better able to seek state protection. Second, as challenges to the new protection monopolists become less frequent, violent crimes will decrease. In the best scenario, the state would regain a monopoly on the organized use of violence. In the meantime, it is the ability of the Russian people to circumvent existing regulations that offers the best hope that reforms will be allowed to proceed.