BENDING THE BARS OF THE IRON CAGE: BUREAUCRATIZATION AND INFORMALIZATION IN CAPITALISM AND SOCIALISM

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ABSTRACT

Despite some important similarities, capitalism's informal economy and socialism's second economy are not functional equivalents or structural counterparts. Both informal economies are responses to bureaucratization; but because the sources, loci, and forms of rationalization differ across the two social systems, the consequences of informalization differ as well. In market economies, the classificatory codes of regulatory bureaucratization rationalize the relations between employers and workers and promote citizenship rights inside the firm. An informal economy is the product of efforts to circumvent accountability to the explicit rationalizations of bureaucratic conventions. It operates according to principles disparate from those of the rules of internal labor markets but congruent with the market principles that coordinate the formal economy. In the centrally planned economies of state socialism, by contrast, redistributive bureaucratization displaces rather than complements market processes. Where informalization responds to the contradictions of redistribution, the embryonic market relations of the second economy are incongruent with the bureaucratic principles that coordinate the formal economy and, in fact, stimulate the institutionalization of transactive market relations and the expansion of property rights inside the socialist enterprise. As a sphere of activity relatively autonomous from the state, the second economy is a source of fundamental change remaking the economic institutions of socialism.

RESUMEN

A pesar de algunas similitudes importantes, la economía informal del capitalismo y la segunda economía del socialismo no son equivalentes funcionales o contrapartes estructurales. Ambas economías informales son respuestas a la burocratización; pero debido a que las fuentes, las lugares y las formas de racionalización son diferentes en los dos sistemas sociales, las consecuencias de la informalización también son diferentes. En las economías de mercado, los códigos clasificatorios de la *burocratización regulatoria* racionalizan las relaciones entre empleadores y trabajadores y promueven los derechos ciudadanos dentro de la empresa. Una economía informal es producto de los esfuerzos por evitar la responsabilidad frente a las racionalizaciones explícitas de las reglas burocráticas. Ella opera de acuerdo a principios que difieren de las reglas de los mercados internos de trabajo pero que son congruentes con los principios del mercado que coordinan la economía formal. En las economías centralmente planeadas del socialismo de estado, por el contrario, la *burocratización redistributiva* desplaza mas que complementa los procesos de mercado. Donde la informalización responde a las contradicciones de la redistribución, las relaciones embrionarias de mercado de la segunda economía son incongruentes con los principios burocráticos que coordinan la economía formal y, de hecho, estimulan la institucionalización de las relaciones de mercado transactivo y la expansión de los derechos de propiedad dentro de la empresa socialista. Una esfera de actividad relativamente autónoma frente al estado, la segunda economía es una fuente de cambio fundamental que modifica las instituciones económicas del socialismo.

Across the diverse societies of contemporary state socialism a second economy is growing in the shadows of the central plan. From Hungary to Hunan, peasants manage decollectivized farms or cultivate household plots after work on cooperatives or collectives, private artisans run shops and transport goods, and manual workers and white collar employees moonlight in construction, manufacturing, service, and repair. This paper addresses the question of whether and how this second economy of income generating activity outside the boundaries of the formal, centrally directed economy of contemporary state socialism can be compared to the informal economy operating outside the officially institutionalized rules and regulations that govern the employment relation in the formal economy of capitalist society.

Until recently, the starting point for such a comparison would have been the assumption that the private entrepreneurial activity of the second economy was alien to state socialism. Official ideology and Western analysts alike portrayed petty commodity production as a relic of a pre-socialist past: self-employment and other forms of small-scale production were holdovers from a previous era inevitably replaced by (depending on the perspective) the superiority of socialist ownership, the technical efficiencies of large-scale production, or the irrepressible onslaught of proletarianization throughout the world-system. For others, the second economy was not a holdover from the past but a transplant from a competing social system: the private character of second economy production, its greater cost sensitivity, and its market orientation all bore the indelible mark of capitalism. Whether as cancer or as cure, the second economy was foreign tissue in the socialist body and its growth the sign of capitalism as communism's future. In either view, further development along a socialist trajectory would preclude the expansion of the second economy.

These assumptions about state socialism find striking parallels in the received wisdom about the tendencies of Western market economies in which the forms of petty commodity production, self-employment, and various unregulated activities now often embraced under the label "informal economy" were, likewise until recently, seen as alien to modernizing capitalism. Whether conceptualized as the laws of concentration and centralization, the dynamics of modernization, or the logic of rationalization, at the center of modern capitalism were processes that, while differentiating functions, homogenized organizational forms. For the unilinear models of Marxism and modernization theory alike, processes of informalization were backward looking, surviving in pockets of tradition or of outdated modes of production as yet untouched by the inevitably all-embracing sweep of large-scale industrial production, corporate forms, legal norms, and bureaucratized employment. Marxist, Weberian, and Parsonsian analysts could agree that the problem for comparative analysis of the informal sector was essentially a question of timing and speed: destined for disappearance in both cases, in which social system would the informal economy be eradicated sooner?

Research over the past decade, however, suggests an alternative interpretation of the relationship between modernity and informality in which proletarianization and informalization grow in tandem rather than through mutual displacement. Studies in Third World economies, for example, indicate that rates of activity in urban petty commodity production have remained stable throughout the recent period of accelerated industrialization (Portes and Sassen-Koob, 1987; Moser, 1978). Far from homogenization, the growth of industrial wage labor generates diverse patterns of organizational forms as households and firms[1] adopt informal employment strategies (subcontracting, outcontracting, homeworking, undocumented work, etc.) to mitigate the consequences of the process of proletarianization itself (Portes, 1983; Roberts, 1989). Findings that informal economic activity shows little sign of stagnation and decline in *advanced* capitalist societies[2] such as Italy (Capecchi, 1989), Spain (Benton, 1989), Belgium (Pestieau, 1985), the Netherlands (Renooy, 1984), Sweden (Hansson, 1989), and the United States (Portes and Sassen-Koob, 1987; Waldinger, 1986) similarly suggest that capitalist development may actually stimulate rather than eliminate the informal sector (Castells and Portes, 1989). Employers turn to informal subcontracting, outcontracting, and industrial homeworking as alternatives to factory based wage labor and its attendant rights and benefits in even the most thoroughly modern sectors of the economy (Pfeffer and Baron, 1988; Lozano, 1989).

The comparative analysis in this paper takes its point of departure from the insight suggested by such recent research that informal economic activity is not anomalous but an integral feature of modern capitalism. It argues analogously that the second economy is not an alien element but one of the basic economic institutions of contemporary state socialism. In so doing, it breaks with modernist assumptions about the homogenization of economic life in rationalized forms. Not a holdover from the traditional and the customary, informalization is a product of the modern and the bureaucratic. East and West, informal economic activity is reproduced in counterpoint to rationalization and bureaucratization.

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[1] In its initial stage, (e.g., Hart, 1973; Weeks, 1975) research on the informal sector examined patterns of self-employment in the informal service sector of developing economies as a means for urban poor to cope with the disruptions of migration and wage labor. The second decade of informal sector research in the Third World has changed the unit of analysis from the survival strategies of households to the employment strategies of firms (Portes and Benton, 1984; Beneria and Roldán, 1987). It thereby shifts attention from such marginalized occupations as hawking, peddling, and backyard brewing to jobs in manufacturing. Such informal manufacturing employment can be sizeable. Roberts (1989), for example, estimates that 40 percent of Guadalajara's labor force in manufacturing is informally employed.

[2] As in the Third World, efforts by sociologists to understand the informal economy in advanced capitalist societies focused initially on the strategies of households in such activities as "self-provisioning" (Gershuny, 1979) and "work outside employment" (Gershuny and Pahl, 1982). More recent studies examine the employment strategies of firms (Organization for Economic Cooperation and Development [OECD], 1986; Fernández-Kelly and Garcia, 1988, 1989.)

But we should not conclude from this simple comparison that capitalism's informal economy and socialism's second economy are functional equivalents or structural counterparts. Both informal economies are responses to bureaucratization; but because the sources, loci, and forms of rationalization differ across the two social systems, the systemic consequences of informalization differ as well. As we shall see, despite some important similarities between the informal sector and the second economy, the two phenomena differ fundamentally in their causes, their reproduction, and their economic, political, and social effects.

Explaining these similarities and differences requires a strategy of comparative inquiry that analyzes relations among institutions rather than essentialist features of a society's institutional elements. In such a relational analysis, to understand the distinctive patterns of informal economic activity under capitalism and socialism we must shift our focus from the informal economies in themselves to the relationship between each informal economy and the formal economy with which it coexists. Moreover, in the analytic strategy adopted here, at the same time that we are examining the patterns of relations among institutions *within a system* we are also comparing patterns of relations *across systems*. In such a comparative analysis, the specificity of a particular institution is given by its position within a configuration of relations within and across systems. It is not the case that the institutions of capitalism provide the standard against which those of socialism (or *vice versa*) can be measured according to the degree of conformity or the direction of their convergence or divergence. Nor is it the case that the analyst brings some universal standard to produce *a priori* definitions that, for all their logical rigor, reflect only the *ad hoc* circumstances of the position of the analyst within the field of debate. Instead, the effort here is to use empirical materials and theoretical insights from both cases to construct a model in which the terms of comparison emerge as properties of the overall comparative configuration. In this way, the institutional specificity of each system is revealed through their simultaneous and mutual contrast.

In concrete terms, a relational analysis of informal economic activities requires systematic attention to key aspects of the formal economies alongside which they are reproduced. In the following investigation, informality is examined in relation to 1) the dominant form of bureaucratization and 2) the dominant mechanism that coordinates activities across firms in the formal economy. These analytic dimensions, it should be noted in advance, do not necessarily refer to mutually exclusive processes: as we shall see, one of the distinctive features of state socialism is that the dominant coordinating mechanism of the economy is itself bureaucratic. In short, if informalization responds to patterns of bureaucratization that differ both in scope and in type, we must develop concepts for the comparative study of bureaucratization before we can understand systemic differences in the dynamics (causes, processes, and effects) of the informal economy in advanced capitalism and the second economy in state socialism.

To anticipate the argument briefly, in terms to be defined and elaborated below: In market economies, the classificatory codes of *regulatory bureaucratization* rationalize the relations between employers and workers inside the firm, establish and monitor basic standards governing the wage-labor transaction, and provide a legal institutional framework for the broader market mechanisms through which resources are channeled throughout the economy. Formulated by an emerging class of professionals who mediate class relations from positions inside private firms and state agencies, the adoption of these official codes is promoted by an alliance of these professionals with trade unions and state managers. In response to this regulatory bureaucratization, an informal economy operates according to principles disparate from those of the classificatory rules of the internal labor market but congruent with the market principles that coordinate the formal economy. In the centrally planned economies of state socialism, by contrast, *redistributive bureaucratization* is the product of a new class project differing both in scope and type as rationalized bureaucratic instruments were introduced to displace rather than complement market processes. In a modern redistributive system, the allocation of resources throughout the economy is coordinated through centrally controlled budgetary mechanisms. Where informalization responds to such redistributive bureaucratization, the embryonic market relations of the second economy are incongruent with the bureaucratic principles that coordinate the formal economy and, in fact, stimulate the institutionalization of transactive market relations inside the socialist enterprise. As an alternative institution in which skills and effort often find a higher rate of return, the second economy increases the maneuverability of labor and provides an opportunity for an alliance between workers and a new class of entrepreneurs. The relational methodology of a comparative institutionalist analysis thus turns our attention from superficial similarities between capitalism's informal economy and socialism's second economy to examine underlying similarities and differences between the second economy under state socialism and trade unions in capitalist societies. Whereas the rationalization of the employment relation under capitalism was often accompanied by an expansion of citizenship rights inside private firms, the emergence of more open, transactive bargaining by labor in the socialist economy is accompanied by an expansion of property rights in statist organizations as well as in the second economy.

Regulatory Bureaucratization and the Informal Economy

Our analysis of the regulatory bureaucratization that characterizes market capitalism (in contrast to the redistributive bureaucratization of state socialism) begins with the noncontroversial observation that the history of the employment relation in capitalist development is one of increasing rationalization. At the century's turn there were no "labor relations" between owners and workers where the inside subcontract specified payment for a given quality and volume of production but left supervision, wages, and working conditions to the discretion of the foreman/subcontractor (Nelson, 1975). Since the days of the internal markets of the "sweating" system, supervision has been bureaucratized and almost every aspect of the employment relation is now subject to bureaucratic regulation. In union and nonunion settings, work is governed by rules, output measured by standardized performance indicators, grievances formalized, and hiring, firing, and working conditions subject to state regulations. Where production was once governed by the patriarchal craftsmen's moral code of "manly bearing," (Hinton, 1973) we now find the personnel department's occupational codes for job evaluations and the human resource manager's codings of job satisfaction questionnaires.

It is in accounting for this transformation from subcontracting on internal markets to supervision in routinized hierarchies that analysts disagree. Some argue that the motive for and outcome of this bureaucratization has been increasing capitalist control over the labor force (Braverman, 1974; Edwards, 1979); others point to efficiency gains from economizing on transaction costs (Williamson, 1985). Both control and efficiency theorists, however, agree in their portrayal of employers as the primary agent of the rationalization process. In contrast to both schools, recent empirical investigations by sociologists and social historians offer an explanation of the bureaucratization of the employment relation that casts central roles for trade unions, professionals, and state agencies. Stark (1980), for example, argues that the timing and patterns of the introduction of scientific management are best explained when viewed as a new middle class project led by industrial engineers against the initial resistance of industrialists, senior managers, and shop-level foremen. The diffusion of work measurement schemes pioneered by Taylor, unsophisticated by our own standards but nonetheless critical in charting the kinds of cognitive abstractions used in today's job evaluation programs, required an alliance of industrial engineers, trade union leaders, and state officials under wartime conditions after Taylor's death in 1915. Baron et al (1986) similarly demonstrate that World War II was the backdrop for a wave of bureaucratization as state agencies, with trade union support, encouraged (and indirectly subsidized) the proliferation of personnel departments, formalized job definitions, and standardized wage and skill classifications. Jacoby's (1985) historical overview likewise documents how trade union and personnel professionals advocated, and employers repeatedly resisted, the kinds of bureaucratic practices we now associate with internal labor markets. The study suggests a cyclical, though cumulative, process in which bureaucratic innovations articulated by middle class reformers in one crisis are set aside in the intervening period and only come to be institutionalized in the subsequent crisis.

If crises such as war and depression (Block, 1987) provide the setting for remaking the economic institutions of capitalism, this rationalization has been undertaken by a set of new middle class occupations in pursuit of their own self-perceived interests to establish and expand their autonomy in bureaucratizing organizations. Far from a set of "empty places" waiting to be "filled" by contradictory class occupants (Wright, 1978), middle class professionals have had an active role in creating and shaping their new positions[3] through a professional project that carves a new class space by offering its services as the mediator of relations between classes and the referee of relations among market competitors. At stake for the new class professionals in the multi-sided class struggle is their claim to a monopoly of the means of classification. The regulatory bureaucratization that has rationalized the employment relation operates through a set of codes—systems of classification that delineate various categories of persons and practices and demarcate boundaries of eligibility and liability. The new middle class professionals and officials affiliated with trade unions, personnel departments, and regulatory state agencies specialize in developing the classificatory instruments used for making these bureaucratic taxonomies. Throughout the century, they have attempted to expand their autonomy by claiming that each occupied a unique role in mediating relations between workers and managers and that the employment relation is best regulated by the formalized structures it promoted. Whether it be in the formalized grievance procedures of the AFL-CIO, in the scientific trappings of Frederick Taylor's time and motion studies, or in Alba Edwards' conviction that his census occupational categories would be an instrument of class harmonization (Conk, 1979) we see the project of class mediation expressed in the modality of formalization and codification. These and other agents of formal institutionalization specialize in the production of rationalized conventions without which the bureaucratic regulation of employment would be impossible.

The use of such rationalized conventions to regulate employment inside the firm is perhaps best epitomized in the institution known as an "internal labor market"—the set of formalized procedures governing hiring and layoffs, routinizing incremental wage and salary rewards, and regulating promotion along graded job ladders (Doeringer and Piore, 1971; Osterman, 1984). These institutional practices are curiously labelled: internal labor *markets* are, in fact, a set of internal *bureaucratic rules*, which operate according to a classificatory logic (Stark, 1986). Eligibility for promotion or exemption from layoffs, for example, depends on membership in designated categories—seniority, skill grades, etc.—in an official system of classification. In such a system, negotiations at the bargaining table, in personnel departments, or in the courts often center on the construction of categorical membership, as can be seen in the recent

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[3] In arguing against control and efficiency explanations and in emphasizing the formalizing impulses that come from outside the firm, this alternative perspective on bureaucratic rationalization is broadly consistent with the new institutionalism in the sociological analysis of organizations (Meyer and Rowan, 1977; DiMaggio and Powell, 1983). But whereas the new institutionalists in sociology analyze "rationalizing myths," "cultural taken-for-granteds," mimetic processes, and patterns of isomorphism in an organizational universe seemingly unpopulated by social actors (for an auto-critique, see DiMaggio, 1988), the perspective adopted here focuses on the interest-directed action of individuals and groups.

negotiations to alter job classifications in the auto industry (Katz, 1985) or the recent comparable worth controversy over job titles and occupational sex-segregation (Hartmann, 1985; Baron and Bielby, 1986).

The outcomes of such classificatory struggles[4] can have material consequences: these internal bureaucratic rules provide protection from the market as, for example, when those in higher seniority categories are insulated from layoffs during times of market downturns. But regulatory bureaucratization can yield protection from the market even in firms and industries where workers cannot take advantage of the job ladders of internal labor markets. The bureaucratic rules that proscribe discrimination in hiring or arbitrariness in dismissal, that regulate occupational health and safety, that govern union representation, and that determine eligibility for unemployment and accident compensation are made up of codes and classifications that protect workers from the market even as they rationalize the employment relation.

In the absence of this rationalizing process we cannot meaningfully speak of an informal economy.[5] Strategies of informalization are a response to bureaucratization; they mark the limits of rationalization. As Castells and Portes (1989) argue in an important synthetic essay, the informal economy is the product of efforts to escape this institutionalized logic. But their definition of the informal economy as "income-generating activity unregulated by *the institutions of society*…" [my emphasis] fails to capture the specifically rationalized, formalized nature of this bureaucratic regulation. Moreover, it obscures the fact that the informal economy is "regulated"—not in the statutory sense but in a sociological sense —by the cultural conventions of family, kinship, ethnic, or other institutions in which, as an economy, it is embedded. Unlike the informal codes of everyday life (without which bureaucracies themselves would cease to function), bureaucratized conventions are *rationalized* in a dual sense of the word. Their codification is standardized and their rationale (however much misrecognizing actual intentions and effects) is made explicit.[6] These explicit rationalizations are both a resource and an object of struggle among contending groups and classes; the informal economy is a product of their circumvention. For these reasons, we define the informal economy as a process of income-

[4] "[B]ureaucratic taxonomies are the product of a recording, in accordance with procedures recognized as scientific, i.e., positivistic ones, of taxonomies which are not produced scientifically but negotiated in the bargaining between employers and employed.... Thus, the classification struggle is one dimension, but doubtless the best-concealed one, of the class struggle" (Bourdieu and Boltanski, 1981: 149-51). On class-ificatory instruments and the politics of classification see also Thevénot (1983, 1984).

[5] Prior to bureaucratic regulation there may be "traditional" economies of petty commodity production, but these are not *informal* economies as defined here.

[6] Although actors can be pressed to provide *a posteriori* rationalizations (the "rationale") for unstated cultural taken-for-granteds, bureaucratic conventions are rationalized in advance. "Rationalized" here does not, of course, imply that bureaucratic conventions carry a universally superior *rationality*. On codification and formalization see especially Bourdieu (1986).

generating activity *unregulated by rationalized conventions*, in a legal and social environment in which similar activities are so regulated.

Informalization is, thus, the counterpoint to documentation and codification. The self-employed house painter who works for cash payments to escape the tax codes; those who take informal employment because age alone, whether too young or too old, excludes them from the job ladders of the internal labor market; the female head-of-household on a family assistance program who keypunches or stitches blouses at home at below the minimum wage to evade the provisions of the welfare code; the unemployed member of the United Auto Workers who drives a gypsy cab so as not to be disqualified for unemployment compensation—it is these and not only illegal aliens who perform undocumented work as each attempts to maneuver through or around one or another bureaucratic code.

They are joined in this maneuvering by the sweatshop entrepreneur who disregards health and safety codes, by the politician or state official who tolerates the violations because they reduce the tensions of high unemployment, and by the corporate executive who subcontracts work out to circumvent the narrow job classifications of the same internal labor market once hailed as bringing labor peace to the industry. Both these workers and these employers seek flexibility to escape the cells of classificatory taxonomies; the difference is that for the worker, the informal economy adds at best some marginal increment of maneuverability whereas for the employer, informalization can add considerably to profitability. Definitions of the informal economy as activities that generate income "not included in the national accounts" entirely miss the point that whether informal activities are counted or not, they are the result of strategies to escape accountability in terms of the explicit rationalizations of bureaucratic conventions. For example, employers in unionized settings who resort to subcontracting, outcontracting, and industrial homework are, in effect, saying that rules negotiated with the union "are of no account" when it comes to informal employment. Undocumented work is unprotected work, and the evasion of bureaucratic classifications is often a means to lower the costs of labor and reduce its bargaining power.

Redistributive Bureaucracy and the Second Economy

Redistributive Rationalizations

Our analysis of processes of rationalization and bureaucratization in state socialism begins with the idea, born in the Nineteenth Century, that socialism would replace the anarchy of the market with the rationality of the plan. A national economy, no less than a modern firm, could be managed by a visible hand. Against Proudhon's vision of socialism as self-managed cooperatives linked through market ties, Marx derided "craft-idiocy" and argued for a single authority distributing tasks and resources to coordinate production for the whole of society. The modern factory provided the model for such economy-wide direct coordination:

> Society as a whole has this in common with the interior of a workshop, that it too has its division of labour. If one took as a model the division of labour in a modern workshop, in order to apply it to a whole society, the society best organized for the production of wealth would undoubtedly be that which had a single chief employer, distributing tasks to the different members of the community according to a previously fixed rule (Marx, 1847/1963: 135).

For Lenin, too, socialism's superior rationality rested in ascertaining what was scientific in capitalist methods in order to promulgate standardized rules at the level of the national economy:

> When the working class has learned how to defend the state system against the anarchy of small ownership, when it has learned to organize large-scale production on a national scale along state capitalist lines,… the consolidation of socialism will be assured… Socialism is inconceivable without large-scale capitalist engineering based on the discoveries of modern science. It is inconceivable without planned state organization, which keeps tens of millions of people to the strictest observance of a unified standard in production and distribution (Lenin, 1918/1970: 693-4).

Lenin's call for a "unified standard," of course, echoed the manifestos of his contemporary, Frederick Winslow Taylor, who advocated scientific measurement, routinization, and standardization. But a comparison of the two great organizational theorists of the first decades of our century suffers from a misplaced concreteness if, as in most studies (Merkle, 1980; Schor, 1981), it focuses on Lenin's fascination with Taylor's scheme as it might be applied inside the new Soviet factories. As the above passage indicates with its emphasis on bringing tens of millions under unified standards through planned state organization on a national scale, the Leninist new class project resonated with the Taylorist endeavor but differed dramatically in scope: whereas Taylor's followers attempted a rationalizing project of increasingly calculable, predictable, standardized control of the supervisory process in the micro sphere at the level of the firm, Lenin's followers, in their new class project, attempted rationalization in the macro sphere as they sought to bring an entire national economy under rational control through the budgetary instruments of central planning. Accompanying this difference in scale, moreover, was a striking difference between the legitimating principles claimed by the new middle class professionals of advanced capitalism and those claimed by the party elite of state socialism. Both class projects were tied to knowledge claims. But whereas the scientific management of the firm claimed legitimacy on the basis of "laws" derived from "time and motion studies," the ability to manage an economy scientifically rested on claims to knowledge of the "laws of motion of history."

As a consequence of the difference between these new class projects, bureaucratization under state socialism is not simply broader, deeper, and more encompassing than in the West, but also differs in type. Bureaucratization under capitalism is *regulatory*; in state socialism, bureaucratization is *redistributive*. In advanced capitalism, internal bureaucratic rules and external bureaucratic regulations occur in a context in which transactions between economic units and the allocation of resources across firms are coordinated through markets. Within firms, resources may be allocated bureaucratically; across firms they are market-coordinated. In state socialism, by contrast, relations between economic units are themselves bureaucratically coordinated and resources across them are bureaucratically allocated.[7] Whereas regulatory bureaucratization in capitalism monitors (and reproduces the conditions for further) transactive market exchanges among private owners of various factors of production, redistributive bureaucratization in state socialism centrally allocates resources through budgetary measures linking units held in public ownership.[8] Paradigmatically, state agencies in capitalism issue regulations policing the rules of the game among market competitors and demarcating the broad parameters within which market activity occurs. Under socialism, the state issues directives specifying organizational goals and detailing economic performance criteria not as "interventions" which must be justified over and against the rights of private owners but as the solely legitimate prescriptions for economic behavior where the state owns (at the extreme, all) productive assets.

To be sure, the state in advanced capitalism can seek to shape the flow of resources through, for example, investment credits, sectorally varied taxation policies, and fiscal and monetary instruments. Under socialism, however, the state does not simply influence investments; it controls them directly by appropriating resources produced throughout the economy and redistributing them back through ministerial budgets.[9] Similarly, although wage and price controls under capitalism might go so far as to include quite detailed centrally regulated wage guidelines, under socialism the state not only establishes wage levels but also centrally allocates to enterprises the very funds from which wages are paid.

Redistribution and its Dependencies

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[7] Capitalist societies, of course, have some redistributive features, and market mechanisms are not entirely absent in state socialism. But in both cases the alternative principle is subordinated to the respective dominant allocative mechanism.

[8] The concept of redistribution, thus, differs from familiar notions of income redistribution through "transfer payments" since, in state socialism redistribution is not an auxiliary principle modifying market outcomes (through taxation of incomes generated on the market) but assumes the dominant role as the coordinating mechanism of productive activity itself. For a pathbreaking analysis of modern redistributive systems drawing on Polanyi's (1957) distinction between markets, redistribution, and reciprocity as "modes of economic coordination," see Konrad and Szelenyi (1979).

[9] Thus, although reforms in Hungary have introduced some measure of market coordination in relations between firms, the redistributive character of the economy persists in the budgetary appropriation of enterprise profits and their redistributive allocation through subsidies and investment funds. This process has been empirically documented and analyzed in a rigorous and comprehensive study by Kornai and Matits (1987).

In a redistributively coordinated economy, enterprises depend to an extraordinary degree on central authorities for strategic directives, operating instructions, and the resources (funds for investments, supplies, and labor) to meet these objectives. At first glance it might seem that public ownership and hierarchical authority give the central ministries enormous power to control the behavior of enterprises under their nominal command. But dependence can frustrate rather than facilitate control, for dependents cannot be held entirely responsible for their actions. As with children in the domestic household, so with firms in the socialist economy: responsibility is inversely proportional to dependence. An enterprise whose director dutifully follows detailed instructions from the center to the very letter of the rule can scarcely be blamed when it produces only losses. And when expenses exceed revenues the enterprise can usually point to administrative encumbrances that justify another increase in the allowance. The paternalism institutionalized in public ownership guarantees the firm's survival regardless of its performance. Because it can acquire resources and investments without demonstrating credit-worthiness or covering costs from the proceeds of sales, the socialist firm faces only a "soft budget constraint" (Kornai, 1986).

Under conditions of soft budget constraints, the firm has little pressure to use resources and investments efficiently. In fact, it often has every incentive to use them inefficiently: rewarded for expansion and physical output, the socialist firm's managers seek to maximize the resources allocated to it and to hoard and hide as reserves the resources it does obtain. For this reason, the firm's demand for capital and labor is theoretically limitless. This perpetual hunger for resources, in turn, gives rise to chronic shortages throughout the economy as firms pump the state for more workers, equipment, raw material, and investments irrespective of their financial situation or ability to use those resources efficiently. In terms of the systemic limits of production, we might say that whereas the firm in a competitive market stops production at the point at which demand has ceased, the socialist firm keeps on producing at whatever the cost, stopping only when it runs out of mobilizable supplies. The problem for the socialist firm is that supply failures, far from being exceptional, are an everyday consequence of the chronic shortages of a redistributively managed economy.[10]

To cope with uncertainties of supply and changes in output targets, managers of socialist firms hoard labor as a flexible factor of production. If the capitalist firm tends to lay off or at least stop hiring workers as a response to uncertainties of demand, the socialist firm hires more workers to mitigate uncertainties of supplies. Whereas the "reserve army of labor" stands unemployed

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[10] The problem for the socialist consumer is that firms exhaust available supplies and resources before they exhaust consumer demand. It is in this sense that János Kornai (1979) labels the planned economy "resource-constrained" at the macro level as opposed to the typically "demand-constrained" market economy.

outside the gates of the capitalist firm, the “labor reserves” of state socialism are underemployed inside the enterprise.

The internal labor reserve of the socialist firm can be mobilized during rush work at the end of planning periods or allocated to deal with “forced substitutions.” On these latter, and frequent, occasions when the firm must produce with inputs that are available rather than those called for in technological prescriptions, labor reserves might be used to process raw materials in-house, modify production processes, and retool equipment to adjust to unstandardized flow-through. Moreover, because capital goods are often kept in operation beyond the point of technical obsolescence (a low scrapping rate is the by-product of capital shortage) and equipment maintenance is postponed during storming periods, machines are prone to breakdowns and require workers with idiosyncratic knowledge. The attempt to scientifically manage an economy as if it were one factory prevents the scientific management of any given factory. External dependence on a redistributive bureaucracy produces internal dependence on a cooperative labor force. This dependence forms the basis for “selective bargaining” (Stark, 1986) by workers inside the firm and for the second economy outside it. To illuminate these processes fully, we must turn our attention from relations between enterprises and central ministries to those between enterprises and households.

Expenditures of Labor

With the nationalization of banking and industry and the near elimination of small private proprietors in agriculture and services, the modern redistributive economy, as noted above, represents an unprecedented concentration of ownership of productive assets. But there is one asset, vital to our understanding of the dynamics of state socialism, that has not been nationalized. For, with the exception of short and highly unstable periods, labor remains *de facto* and *de jure* the property of individuals and households. On the side of the firm, the private character of labor means that managers face the problem of getting labor from labor power, i.e., to turn the wheels of nationalized industry they must find measures to stimulate the performance of “private” owners of labor. On the side of the household, because so few other assets are privately held, households have virtually no sources of income other than earnings from labor.

These needs and interests would appear congruent, and indeed they are—to a point. The firm’s almost insatiable appetite for labor combines with households’ search for wages to produce labor force participation rates much higher than those of Western Europe. But at the point that the household has pushed all its able bodies into active wage earners, it can no longer improve its standard of living by an “extensive” increase in the rate of participation but looks to more intensive utilization of labor at higher rates (and perhaps alternative forms) of remuneration. Similarly, enterprise managers have an interest in securing the largest possible wage fund in order for the firm to retain its (idiosyncratically skilled) labor force and stimulate their efforts. But this lobbying on behalf of the firm and its employees cannot yield boundless fruits: enterprises are competing for wage funds from that fixed proportion of national income that central planners allocate for labor. And, in the logic of redistribution, the winners in this competition are not likely to be those firms with greater efficiency, higher profitability, or with more rational incentive structures.[11] For these reasons, a significant proportion of workers confront a gap between the level of effort that they are capable of and willing to expend and the level of reward that they are likely to receive.

Workers' response is conditioned by a situation in which households, in contrast to firms, face hard budget constraints. Because its expenses must be covered by income, the household is cost-sensitive and attempts to economize its resources. As such, it seeks the best return on expenditures of labor, its sole income-generating resource. Some workers can improve the reward/effort ratio through informal negotiations on the shop floor (Héthy and Makó, 1972; Kalász and Köllö, 1984). This process has been characterized as *selective* bargaining (Stark, 1986) not only because of its *ad hoc* nature but also because it is limited to those workers whose skills, idiosyncratic knowledge, or strategic location at key points in the production process provide an exploitable dependence (Köllö, 1984; Stark 1986; Ladó and Tóth, 1988). Others can use turnover to yield short-term wage improvements. But the attraction of higher basic wages (as the only earnings indicator visible to an outsider) can make turnover a self-defeating strategy where longer-term wage gains accrue through bonuses and *premia* not linked to the basic wage. Quitting too often for initially greener pastures can preclude building up the contacts and connections through which bonuses, *premia*, and easy overtime are channeled (Lukács, 1986). Given the drawbacks of turnover and the limitations of selective bargaining, a rational strategy for the economizing household is to attempt to maintain the price of labor power while reducing the actual expenditure of labor. Thus, corresponding to the hoarding of a labor reserve by the firm as a hedge against bureaucratic uncertainties, we find workers withholding labor in production.

To the economizing household, labor withheld from the socialist firm is labor that can potentially be utilized elsewhere. The first outlets close at hand are self-provisioning activities such as home-building, repairs, and gardening. But labor that the household is capable of and willing to expend can also be employed in the off-hours selling skills to other households where the socialist sector leaves vast unfulfilled demand in construction, repairs, or personal services (sometimes with tools and materials "borrowed" from the place of regular employment) or providing goods of higher quality than those available in the socialist sector. The growth of private construction, in turn, stimulates private transport of construction materials, and the more intensive

[11] Gábor and Kövári (1985), in fact, demonstrate that recent changes in the distribution of wage funds penalize firms that utilized labor more efficiently in the previous round.

cultivation of small household plots not only increases demand for transport of agricultural products but also creates a market for the skills of designers and machinists to produce new technologies (small horsepower tilling equipment, heating pumps for plastic covered hot-houses, etc.) appropriate for small-scale, intensive agriculture. More private vehicles and more private equipment, of course, generate more private jobs in repair. And as moonlighting jobs grow in number, so grow the opportunities for economizing households to compare earnings in the off-hours with those in the firm. Increased opportunities for exit yield, in turn, an increase in the number of workers who can participate in the selective bargaining over efforts and rewards. Managers, for their part, are often forced to tolerate this partial exit, even though it steadily erodes the incentive power of enterprise wages, for such may be the only option to retain the firm's employees. The operation of the modern redistributive economy thus gives rise to a second economy as an integral feature of state socialism.

Dimensions of the Second Economy

By second economy we refer to a broad range of income-generating activity outside the boundaries of the redistributively coordinated and managed economy. Second economy units are privately owned, and, like households and unlike socialist firms, face hard budget constraints. Their external relations are coordinated through markets or networks of reciprocity, and the management of their internal affairs (decisions about investments, operations, wages, etc.) is not governed by official policies and protocols. Some second economy activities are legal and some are illegal;[12] but many second economy activities cannot be easily categorized within the dichotomy of legal or illegal. Such is the case when taxation, credit, and purchase and supply policies are written in such a way that even the most scrupulous private producer cannot be in consistent compliance with mutually contradictory regulations. Nor can the dynamics of the second economy—its expansion and contraction or its qualitative transformation—be written simply as a history of the tightening or loosening of legal restrictions. On the one hand, legal prohibitions in themselves cannot curb a second economy where violations are the norm and enforcement the exception. On the other, legalization in itself cannot make a shadow economy into a legitimate private sector where a distrusting populace fears re-expropriation and where even legal and formally registered activities have an official status as less than fully legitimate.

[12] As such this definition differs from earlier conceptions (e.g., Grossman, 1977) of the second economy as *illegal* income-generating activity. Because we define the second economy in relation to redistributive bureaucracy, the relevant criteria involve the patterns of ownership, budget constraints, external coordination, and internal governance of the second economy units rather than their legal status. For the most elaborated and analytically useful definition of the second economy, see Gábor (forthcoming).

For these reasons we refer, as do the Hungarians, to a large part of the second economy as existing within a zone better captured by the terms “alegal,” “not illegal,” or the “tolerated.” Above all it should be understood that this tolerated zone is not fixed by legislative initiative or the beneficence of officialdom. In the late 1960s and throughout the 1970s, Hungarian peasants and workers did not sit on their hands waiting patiently for the government to pass new legal measures but ventured into the second economy forcing the state, in one field after another, to tolerate activities that were once illegal but were not yet legalized and to institutionalize forms that were legal but were not yet legitimate. The boundaries of the second economy and the relative proportions of its legal, illegal, and alegal parts are products of contestation between state and society—a continuously changing outcome of a struggle in which society attempts to create and maintain a sphere of activity relatively autonomous from the state.

We may speak of the relative autonomy of the second economy to the extent that its organizing principles are different from those of the redistributive state and its processes are insulated from control by state elites.[13] This does not, of course, imply that the systemic reproduction of the second economy is isolated from the socialist economy or that its participants have severed their ties with the socialist sector. In fact, because participation in the second economy is seldom undertaken on a full-time basis, most second economy producers continue some kind of employment in socialist firms. This strategy is motivated in part by the goal of maintaining security of employment and access to health insurance, housing credits, and other benefits that are conditional upon holding a job in a socialist enterprise.

The decision not to invest all of one’s financial and human resources in full-time private pursuits is also shaped by the state’s contradictory policy toward the second economy. State managers in socialist economies regard the second economy with an ambivalence not entirely unlike the posture of some capitalists towards the welfare state in our own societies. On the one hand, politicians are conscious of the compensatory effects of the second economy (as a safety net for some families, auxiliary supplier for some industries, and an alternative means to raise the standard of living for the majority of households) and, on that account, support policies that tolerate its existence. On the other hand, state elites fear that the second economy threatens the dominant ideology and weakens the incentive power of wages in the socialist economy. For this reason, they adopt policies that constrain its expansion, lead to its distorted reproduction, and discourage full-time participation. These policies include capricious taxation measures that make it difficult to predict future tax liabilities; severe limitations on the availability of legal credit; and

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[13] The allusion to the debate about the “relative autonomy of the state” in capitalist societies is deliberate. Whereas the political sociology of advanced democracies has been revitalized by “bringing the state back in,” the political sociology of state socialism will be revitalized when it ceases to be preoccupied with structures of the party/state and brings society into focus (Stark and Nee, 1989).

practices that put second economy producers at the end of the queue when having their purchase orders filled by socialist suppliers and last on the waiting lists to be paid when they do business for firms in the state sector (Galasi and Gábor, 1985).

These and similar policies have the (not entirely unintended) consequences that small-scale producers must resort to under-the-table dealings such as systematically underreporting income, offering bribes and kickbacks to acquire materials and contracts, and obtaining illegal credit at often usurious rates.[14] Technical violations of legal restrictions prompt renewed charges of blanket illegality and corruption in the second economy and fuel efforts to restrict its expansion which, in turn, heighten the perceived threat of expropriation and discourage further investment in productive assets. Shortage conditions, moreover, can produce windfall profits even for private producers who have conscientiously avoided any corruption and who, in the absence of legal avenues for productive investments, spend these on large houses and big cars. The visibility of this consumption increases the likelihood of public complaints against "unearned incomes," and this condemnation engenders more fear among small-scale producers, which further discourages the would-be full-time entrant.

The end result is the low propensity to invest legally in the second economy, the tendency for such investment as does take place to be directed toward immediate and short-term gain, and the decision not to opt out of employment in the socialist sector. The shortage nature of the socialist economy perpetuates a situation in which only a minority of households live solely from first economy earnings; the policy preferences of state elites reproduce a pattern in which only a marginal proportion live solely from second economy incomes. The majority of households derive incomes from both. As István Gábor (forthcoming) argues, "household strategies of parallel and simultaneous participation in both economies become the norm."

For some analysts (Kemény, 1982; Sampson, 1986), income supplements from this dual participation reduce conflicts and tensions that would otherwise build up in the socialist sector. The second economy, in this view, is a kind of safety valve serving ultimately to maintain the system. Although the second economy is an important factor in the overall reproduction of state socialism, recent statistics suggest that the safety valve metaphor understates the extent of second economy activity and thereby fails to capture the contradictory dynamic of state sector/second economy relations. In 1987, for example, small-scale agriculturalists accounted for only 11 percent of arable land but produced over 36 percent of agricultural production (Központi Statisztikai Hivatal, 1987: 34) including 74.0 percent of the vegetables, 60.8 percent of the fruit,

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[14] Forced to engage in such petty corruption, second economy entrepreneurs thereby expose themselves to nefarious means of social control such as official blackmail. For a contrast of forms of control of the informal and second economies see Gábor (1988).

and 53.5 percent of the pigs raised in that year (KSH, 1987: 190).[15] Turning to more urban occupations (with statistics confined to legally registered participants) the number of private retail tradesmen is still small but has risen from 10,229 in 1975 to 31,827 in 1987 and accounts for about 32 percent of commercial shops, restaurants, and bars (with an additional 12 percent of all retail and catering units leased to private management) (KSH, 1987: 261-263). Similarly, the number of registered self-employed industrial producers rose from 103,412 in 1980 to 154,611 in 1987 (KSH, 1987: 407). Hungarian consumers turn to the second economy to buy everything from bread for their kitchen tables to software for their personal computers. Forty-two percent of housing construction (Gábor, forthcoming; see also Sik, 1988) and, by a conservative estimate, almost 85 percent of building repairs (Markó, 1986: 30) are undertaken by second economy producers. According to estimates from survey data, nearly three-quarters of all households derive some income from the second economy (Kolosi, 1980: 41).[16] A recent study by Hungarian economists (using nation-wide time budget microsurveys conducted by the Hungarian Central Statistical Office) estimates that in 1984, 33 percent of all active labor time (excluding housework) was spent in the second economy (Timár, 1985).

The image of a safety valve venting pressure to prevent an emergency seems a particularly inapt metaphor when one out of every three hours worked for income in Hungary occurred in the second economy. Rather than a mere valve, the second economy has become an alternative engine linked, no doubt, through a complex circulation system to the energy of the first economy, but increasingly powered by its own energy drawn from sources that were not tapped by the socialist sector.

Pressures for Change

The more marginal in size and the more illegal in character, the more the second economy is conservatizing in its systemic effects. But with its expansion, the second economy reaches a point where it becomes a source of increasing pressure for change in the first economy. Most important for purposes of our comparison are the changes in the employment relation in the socialist sector brought about by the growth and qualitative transformation of the second economy.

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[15] Polish peasants, too, produce a large percentage of agricultural products privately. In Hungary, however, where only a tiny fraction of the land is privately owned, peasants have *independent institutions for marketing* their products (and not only on local but regional, national, and even international markets). Although privately owned, Poland's farms are part of the redistributive economy; because they are more autonomous in acquiring inputs and in marketing their products, Hungarian peasants are in the second economy outside the redistributive logic even though they do not own the land. See Juhász and Magyar (1983); and Szelenyi (1988).

[16] See Rona-Tas (1989) for an excellent study using Hungarian survey data not only to examine rates and patterns of second economy participation but also to assess consequences for earnings inequalities.

More significant than increasing consumer choice in the quality and availability of products, the expansion of the second economy increases *producer* choice: from no choice but wage labor in the socialist firm, an expanding second economy now provides alternative forms in which to invest productive activity, including such options as self-employment, small partnerships, franchise arrangements, membership in small cooperatives, and waged employment for second economy entrepreneurs. By increasing the opportunities for even partial exit, the second economy expands the room to maneuver for workers inside the socialist firm and increases the likelihood that the terms of employment (wages and conditions of work) will be negotiated through transactive bargaining between workers and managers rather than being administratively imposed. We should not expect that this bargaining will immediately take the form of unionized collective bargaining familiar to us in the West. But to the extent that the second economy increases pressure for change, we should expect that more workers would be brought into the selective bargaining on the shop floor, that the range of negotiable issues would expand, and that this selective bargaining would be increasingly brought out of the shadows to receive official recognition in more institutionalized (but not more bureaucratized) forms.

Evidence that such changes are taking place can be seen in a recent organizational innovation in which groups of workers inside Hungarian factories received the right to form semiautonomous subcontracting units, known as "work partnerships" (*vállalati gazdasági munkaközösséggek*, hereafter VGMs), producing goods or services in their off hours using equipment of the socialist enterprise. The terms of these subcontracting agreements are bargained between unit managers and representatives elected by each partnership (rather than by trade union officials accountable to management), and the undisguised nature of this bargaining is an official recognition of the selective bargaining that formerly took place only in the shadow negotiations of the shopfloor. The selection of members, organization of work, and allocation of the "entrepreneurial fee" are the internal responsibilities of the partnerships and differ, sometimes dramatically, from patterns in the bureaucratically organized "regular hours." In 1987, eleven percent of all employees in industry were members of partnerships with participation rates of 25-30 percent among manual skilled workers in certain heavy industries. Hourly rates of earnings in the partnerships are several times higher than those for comparable work performed in the regular hours. Annual incomes from the VGMs typically range from 30-60 percent of the regular yearly earnings, but some members' off-hours incomes exceed those of the main hours employment.

The operation of the partnership form has been described in detail elsewhere (Laky, 1984, 1985; Stark, 1989, and forthcoming). For our purposes here, two points must be emphasized. First, the establishment of the partnership form was directly linked to the expansion of the second economy. Throughout the 1970s, one social group after another was able to take its skills into the second economy as, for example, peasants won the right to independently produce and market agricultural goods and workers in construction could make legal contracts in home building. Other administrative and legislative actions intended to “integrate the functioning of the socialist economy and the second economy” lifted restrictions on private ventures in such fields as restaurants, professional and technical consulting, and some small-scale industrial activity. By the beginning of the 1980s, however, one politically and economically strategic group still lacked an institutional form for marketing their professional skills in the second economy. These workers, whose counterparts during the same period were leading the Solidarity movement in Poland, were the core of the urban working class—skilled workers in heavy industry upon whom management most depended. If the washing machine repairman in a state firm could gain clients and spare parts from his regular job for his off hours “private practice” and if the peasant could intensively cultivate his own hectare of land, how was the furnaceman in a steel mill or a machinist making sophisticated machine tools to use his special skills within the second economy? The partnership form provides such an opportunity to gain additional incomes in the off hours. As one young machine designer explained during my field research:

> The VGM is a more civilized form than the second economy. I can earn extra money according to my skill and not on a lower level. If you do the work at your same level, you regard the extra money as less humiliating. Let’s say, if I need the money, I don’t need to wash little Aunt Mary’s windows or unload wagons but I can do the work that I like and know well. There aren’t too many possibilities to do design work in the black for enterprises. To design and make a tool can’t be done in “schwartz.” But in the VGM I continue my regular work and so it can bring about some professional development too.

Similarly, an older machinist living in Budapest stated:

> I can’t grow vegetables in a bathtub. Those who live in the countryside have household plots and can earn some money from these, but we in the city don’t have these. In the VGM, though, I can stay in the same place, use my same skills, and work with my same friends.

Or, as a Central Committee member explained to me in an interview, “The VGMs are the household plots of industry.”

Second, as the household plot of industry, the VGM not only supplements incomes but represents a means to escape centralized wage regulations and a new form for allocating and rewarding labor inside the enterprise. The VGMs provide a means to differentially reward strategic workers, tie their interests to those of the firm, reduce turnover, and improve the likelihood of their cooperation within the production process. As such, it performs functions not dissimilar to the “internal labor markets” of the large capitalist firm (Stark, 1986). The difference is that in market economies these mechanisms take the form of internal bureaucratic rules while in bureaucratic economies they take the form of internal market transactions. In fact, in some firms, the terms of agreements and the price of entrepreneurial fees are shaped by a system of internal competition in which groups bid for subcontracts (Neumann, 1986). But whether it be through bidding or through negotiations conducted by the elected representatives, the partnership form of an internal labor market, like the selective bargaining of the regular hours which it makes explicit and institutionalizes, operates according to an affiliative logic of transactive exchanges in which benefits are distributed according to membership in a face to face group rather than through categorical membership in the classificatory groupings of bureaucratic taxonomies.

Thus, whereas workers in capitalist economies differ in the extent to which they are protected from the market, workers in the socialist economy differ according to the extent to which they can participate in the market. In capitalism, informal economy workers tend to fare worse relative to employees in the regulated economy, and subcontracting and outcontracting are typically associated with fewer protections, lower benefits, and an absence of union representation. In socialism, by contrast, rates of earnings are often higher in the second economy and workers who can participate in subcontracting schemes are among the most highly rewarded with access not only to higher earnings but also to alternative means of interest representation.

A Comparative Model of Mirrored Opposition

In examining the relations between regulatory bureaucratization and the informal economy and between redistributive bureaucratization and the second economy, we have argued that the distinctive patterns of each system could be revealed through their mutual contrast. That is, a comprehensive account of systemic differences requires a multi-sided comparison in which we simultaneously 1) compare economic institutions across sectors within systems and 2) compare the relations among sectors across systems. Pursued systematically, in the resulting model the specificity of any given institution is grasped not through some essential traits but only in relation to the broader configuration *within and across* systems.

Figure 1 presents in graphic form the model of such a multi-sided comparison of the dynamics of bureaucratization and informalization under capitalism and socialism.[17] Its elements are taken from the analysis above. For each system we present 1) the coordinating mechanism through which the enterprise is linked to other units in the economic environment, 2) the characteristic feature of internal labor markets, 3) the forces in tension with the dominant systemic

[17] Future investigations should explore comparisons that include level of development as another dimension cutting across capitalist and socialist systems. In such a multi-sided comparison, country cases might include Spain and Hungary; Peru and China.

coordinating mechanism that stimulate the development of these forms inside enterprises, and 4) the informal/second economy.

Most generally, the overall logic of the configuration shows the features of capitalism and socialism as mirrored opposites. Take, for example, the relationship between external coordinating mechanisms and internal labor markets: whereas in

FIGURE 1

Bureaucratization and Informalization of Employment in Capitalism and Socialism

capitalism we find internal bureaucratic rules in a predominantly market environment, in socialism we see internal market transactions in a predominantly bureaucratic environment. Figure 1 also shows the distinctive patterns of bureaucratization in the two systems. As the dominant coordinating mechanism in socialism, bureaucratization is redistributive. Capitalism's regulatory bureaucratization, by contrast, is juxtaposed to the dominant logic of the market and, as a coexisting and opposing principle, stimulates changes in the system—not least of which are changes internal to the capitalist enterprise.

The configuration becomes more complex when we turn to the systemic "locations" of the informal economy and the second economy. Where should they be situated when a direct comparison of their patterns of ownership, budget constraints, economic coordination, and internal governance yields marked similarities? Both are characterized by private ownership, hard budget constraints, and market coordination. And in both cases internal governance is not regulated by bureaucratic procedures (the employment relation, for example, is not regulated by bureaucratic rules governing hiring, firing, promotions, etc.). If our analysis remained at the level of relations internal to each informal economy (whose similarity is captured in Figure 1 by representing each in the same circular form), we might conclude that processes of informalization are essentially the same in the two social systems.

Not confined to comparing internal features of the respective informal economies, our analysis proceeded to examine how the processes of informalization articulate with the broader institutional matrix of capitalism and socialism. Comparing across sectors, we argued that the governance of the employment relation in capitalism's informal economy differs from the regulated labor relations of the formal sector. But if the informal economy escapes regulatory bureaucratization, it does so on the basis of market coordination and private ownership congruent with those of the dominant mode. In the socialist case, these same features are opposed to, rather than congruent with, the dominant mode. Moreover, by this difference, the non-bureaucratic governance of the informal economy stimulates the institutionalization of transactive bargaining inside the firm. We have seen this pattern once before—where an opposed but subordinate logic is a force for change—in the bureaucratization of the employment relation that remade the economic institutions of capitalism. To capture this comparison, the second economy is also pictured in Figure 1 in a triangular form representing a force of systemic change remaking the economic institutions of socialism. As the counterpart to the trade unions, state agencies, and professional associations that promoted bureaucratization in capitalist market economies, the second economy (in a systemic mirrored opposition) is a force of marketization in socialist redistributive economies. Unanticipated at the outset, pursuit of a multi-sided comparison leads us from the surface resemblances of economic informality across social systems to uncover structural similarities between the second economy under socialism and trade unions under capitalism.

If trade unions and the second economy play analogous systemic roles stimulating changes that improve the bargaining power of workers, they do so, of course, through different means.[18] In both cases economic institutions (for example, the internal governance of the employment relation) are reshaped by interest-directed action. But the internal rationalization of employment under capitalism was spearheaded by formal organizations (unions, state agencies, professional associations) whereas the expansion of transactive bargaining under socialism is a product of social organization (unorchestrated actions by individuals and households in their everyday participation in the markets and networks of the second economy). Similarly, if the classificatory rules of bureaucratized employment providing some protection from the market were borrowed from forms developed outside the firm and if the affiliative forms of institutionalized bargaining providing some participation in the market were borrowed from the second economy, in both cases these borrowings were accompanied by an extension of rights. But if the former protection comes about by an extension of citizenship rights (due process, freedom of association, non-discrimination, etc.) into the economy, the latter participation comes about by extending property rights (rights to make contracts, to enter into economic partnerships, etc.) into statist organizations.

Epilogue into the Future: From Second Economy to Legitimate Private Sector

The question of whether these property rights might expand to create a legitimate private sector heads the political agenda in contemporary Hungary. Such a development would signal the emergence of a socialist mixed economy (Stark, 1989; Szelenyi, 1989) rather than state socialism with a second economy. It would reflect a qualitative transformation rather than a mere expansion of the second economy: whereas producers in the second economy supplement incomes, in a fully legitimate private sector they would be free to accumulate capital. Recent measures indicate that the Hungarian leadership is taking such steps. With the economy floundering, new legislation and administrative directives establish the right to form limited liability companies, provide for majority ownership of firms by foreign capital, and allow private Hungarian

[18] In contrast to typical trade union actions to reduce the working day, the second economy extends the working day. In the long term this will have serious consequences for the health of the working population.

firms to employ up to 500 workers (raised from the former limit of 15) in hopes that an expanded private sector will improve performance and promote economic growth.[19]

It is still too early to assess the consequences of these new measures (although preliminary indications are that they have probably not gone far enough to achieve the desired effects). Here we briefly indicate the problems and prospects in terms already developed above. As we look into the 1990s it would be a mistake to assume that the obstacles blocking the creation of a dynamic private sector can be removed by reversing the legal principle according to which "Everything is prohibited that is not explicitly allowed" to a new principle in which "Everything is allowed that is not explicitly prohibited." The switch to the new principle is required, but is not sufficient. That is, the development of a legitimate private sector requires not only lifting restrictions but also establishing new regulations (Nee, 1989). In terms of the analysis above, the limited and distorted markets of the second economy can exist in the interstices of a redistributive bureaucracy; but a dynamic private sector will require some degree of *regulatory* bureaucracy. Because a ruling communist party, no less than the most laissez-faire government in capitalist society, will be reluctant to tolerate an entirely unconstrained market, the switch to new legal principles will entail making explicit more detailed prohibitions in place of the earlier global one. Moreover, private investors are likely to be more confident (or at least less fearful of state intrusions) where prohibitions (if not too great in number) are clearly spelled out rather than unstated. For these reasons, and because dynamic markets require a stable legal infrastructure to facilitate complex exchanges, a socialist mixed economy, in contrast to its state socialist predecessor, will have fewer restrictions but more (precise, formalized, and delimited) regulations.[20]

Despite the qualitative difference between legal-rational regulations and redistributive directives, the two types of administrative practices can be all-too-easily confused in the transition to a socialist mixed economy. On the one hand, bureaucrats accustomed to the redistributive mode might learn new routines when affairs are running smoothly; but when political or economic problems arise, they are likely to slip back into the familiar redistributive patterns—and the proliferation of rules regulating the market may provide the ready pretext to do so. Entrepreneurs, for their part, are quite likely to confuse the more detailed regulations as signs of a hostile

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[19] In the midst of discussions of dramatic change in the industrial structure (including closing down some obsolete plants in heavy industry) some Hungarian leaders have expressed the hope that the growth of the private sector will mitigate the effects of the unemployment that is likely when some socialist firms are disbanded during economic restructuring. This would be a qualitatively new development in the relationship between socialist sector and second economy.

[20] The distinction between the two types of bureaucratization is crucial here. State socialist economies, of course, abound with administrative measures known as "regulations." The point is that many of them are not regulatory in the sense we use it here: regulatory behavior assumes otherwise free scope for autonomous activity.

investment climate even where they are meant to foster investor confidence. And if they slip into familiar patterns of less-than-legal second economy dealings, this is likely to trigger a shift from benignly regulatory to aggressively restrictive state interventions. Decades of mutual suspicion, thus, create the circumstances for two-sided, doubly self-fulfilling prophecies. The most likely outcome, then, will be a cyclical pattern of alternating periods of over- and under-regulation.

The development of a socialist mixed economy will also create possibilities for new class alignments. If present trends continue, in the 1990s we will see the emergence of a new class in Eastern Europe—not Djilas' New Class of party elite but a new class of entrepreneurs accumulating capital. With what social groups might it ally? Will it be with workers to increase the scope of transactive bargaining and open more avenues of exit from the socialist sector? If so, perhaps an expanded and officially recognized private sector will form an embryonic civil society resulting not only in an expansion of property rights but also an expansion of citizenship rights.[21] Alternatively, an alliance of new entrepreneurs and the old state socialist elite may take place. If so, it may turn out to be the case that democratization and the growth of private economic activity have a curvilinear rather than linear relationship in the socialist context with the corruption typical of black markets at one end and with class collaboration to repress workers at the other. Because both these scenarios of alignments are possible, the outcome will be determined by how interests come to be shaped in the clash and pull of transformative politics. In either case, the period of transition from second economy to recognized private sector will be a critical one as alliances forged or broken then will shape the socialism of the coming century.

[21] Whether through the creation of formal organizations of a representational character (such as Solidarity in Poland) or through networks of social organization of reciprocity and exchange (as in the second economy in Hungary), the 1980s have seen the expansion of a proto-civil society relatively autonomous from the state. With constitutional changes, competitive elections, the likely prospect of non-communist cabinet ministers, generals handing over the reigns of government to civilian leaders (as in Poland), and a flourishing independent press, the early 1990s will be a period of democratization in a social context of inflation, crisis, and economic restructuring. These patterns will not sound unfamiliar to scholars of contemporary Latin America. Our understanding of the problems and prospects of democratization should be enriched by the insights that will be produced by comparing such cases as Brazil, Greece, and Poland, or Hungary, Spain, and Argentina.

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