

## ENTREPRENEURSHIP UNDER SOCIALISM: THE CASE OF FORMER SOVIET ECONOMIES

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### 1. Introduction

The entrepreneurial dimension of individual activities is, without a doubt, included in their decision-making sphere, irrespective of their relevant social or economic context.

The entrepreneur we are taking into account in this article is consistent with the conception formulated by the followers of the *Austrian School of Economics*. The entrepreneur's risk-taking and assumption of uncertainty, as well as their knowledge, offer the entrepreneur a market advantage. By pursuing their own interests, the entrepreneur acts in the context of the market process. Thus, the wish to satisfy their own needs is the stimulus that initiates the action. Irrespective of the form it assumes, the goal of the entrepreneurial activity is to achieve a higher level of satisfaction for this market actor. The motivation to achieve more is of an intrinsic nature, and mobilizing all the available forces and resources to reach this goal is a key aspect in the entrepreneur differentiating themselves from other market operators. Klein and Foss also support this statement; they suggest that the entrepreneur embodies the forces of the market in various manners, therefore we should see him as a central figure within the economic process (Foss, N.; Klein, P.J., 2012, p. 24).

In the context of a planned economy, we can neither deny nor ignore the existence of individuals with entrepreneurial orientations, able to take much higher risks than those on a free market. Unlike free societies, in communist or totalitarian societies entrepreneurial activities are legally prohibited, subject to criminal penalty. Given that the entrepreneur's risks are much higher, evidently the risk premium is also much higher. There were major differences between official prices set by decree and those on the black market, which opened the opportunity of obtaining significant profits for entrepreneurs willing to take the much greater risks by carrying out an illegal trade. The risk premium, increased artificially by the fact that entrepreneurial activities were harshly punished by law, made black market prices much higher than they would have been under normal conditions, on a free market. Dissimulating the profits is an extremely difficult mission, therefore the entrepreneur is a *risk-taker*.

### 2. Entrepreneurial action is inherent to human action

Even though the communist society was planned by central authorities, the entrepreneurial dimension of the activities conducted by individuals could not be fully annihilated. Experience of former communist societies points out that an entrepreneurial behaviour is a defining human trait, even if the system means central planning, control and the absence of freedom. As Ludwig von Mises noted, the entrepreneurial activity is inherent to every human action (Mises, 1998, p. 254). Analysing the social-economic context and considering the oppressive conditions enforced by the communist system in which some individuals had to live their life, their testimonials can be deemed as justifications for what is in fact a need to adapt to the new realities of a society.

Control over all the activities carried out by individuals was exercised *via* plans established by the centralized system. However, their objectives could never be achieved because, in reality, they were unachievable (Besançon, 2014, p. 75). The prices for goods and services were established and controlled by authorities, and the tampering with reports and official documents was one of the frequent practices. Precisely because there was a major gap between official statistics and the cruel reality, store racks in former socialist

countries were most of time empty and the population was struggling with genuine shortages, even in terms of food supply. The situation worsened and the state's capacity to provide transparent *rules of the game* that would encourage individual initiative led to the creation of breaches across the entire system.

Under these circumstances, the niches identified by entrepreneur-individuals were exploited and created genuine *black markets* able to satisfy the needs of both consumers and state-run enterprises. The latter could not have conducted the activity mandated under near-impossible plans without some goods provided by this *new market dimension*. The difficulty of achieving plans was also amplified by the fact that state institutions did not provide raw materials for achieving imposed quotas, as they normally should have (Roberts, P.C., LaFollette, K., 1990, p. 7). Nevertheless, the fear that the system managed to instil determined state enterprise directors to come up with various solutions. These solutions included an extensive use of the black market, which largely provided goods that were, in fact, stolen from other state institutions. Sectors of a lesser importance for the Soviet-type economy became dependant on the use of illegally purchased goods in exchange for other goods or services or influence peddling, for the purpose of achieving the plans. The entire underground mechanism that made illegal use of products or services was enabled *via* the influence of notorious persons in the state sector and known as *tolkach* (Roberts, P.C., LaFollette, K., 1990, p. 15).

The entrepreneurial activity carried out on the black market was complementary to that in the planned system and tried to reveal the faults of a chronically ill system. The faults of the planned system were partially corrected *via* the black market, a market developed in parallel against an impossible system that could not possibly work. Its role in the communist era cannot be ignored, particularly since almost all members of the society, irrespective of their job title, resorted to such less than lawful transactions (Welter, F., Smallbone, D., Pobol, A., 2015, p. 2). The most important principle to observe was that nobody knew anything about whatever activities others would conduct.

In a decentralized system, the regulating function of the market mechanism goes to the private sector and to those operating activities therein (Kornai, 1990, p. 58). Taking this principle as a starting point, we can conclude that in the process of adjusting the major distortions caused by the communist system in terms of the scarce resources' allocation mechanism, an essential role went to *informal entrepreneurship*. Most of the time, this took various forms: informal private enterprises, informal trades between individuals that had no right to trade goods or services as they did not hold licenses from the authorities, or state enterprises that traded goods illegally.

### 3. Entrepreneurship under coercion. An analysis of informal entrepreneurship.

The scarcity of resources and the state's incapacity to manage their allotment (which usually occurs on the free market) have led to a wide-scale phenomenon: *queue-standing*. This was one of the methods that enabled the control over the population. A quintessentially Soviet act, queue-standing meant not only political restraint, but also economic restraint and the state of dependency to be instilled in the population reported to the planning authority (Besançon, 2014, p. 67). Waiting in line to obtain necessary goods was a symbol-element for the communist period. Not even the *basic goods* enjoyed a different regime, and the situation became increasingly critical. The impossibility to purchase the basic goods necessary for a decent living led, by way of inventiveness, to finding another method to purchase such goods, thus developing an informal dimension of entrepreneurship, namely *informal entrepreneurship*.

"Acquaintances" (otherwise known as informal connections), bribery and influence in relation to the state offered individuals an edge on the black market, which resulted in the increasing volume of illegal trades. Entrepreneurs tried to set up genuine informal social networks aimed at ensuring a certain predictability in the economic area. Personal relationships would usually be created with business partners (buyers or suppliers) in order to minimize the risks caused by the unlawfulness of the entrepreneurial activity conducted (Ledeneva, A.V., Bailey, A., Barron, S., Curro, C., Teague, E., 2018, p. 61). Paradoxically, corruption was a phenomenon that gave individuals the possibility to conduct entrepreneurial activities in a controlled economic system. Sampson underlines that the entire activity conducted within the underground economy was supported by the corruption phenomenon (Sampson, 1987, p. 126). From the black market, individuals would most of the times purchase *basic goods* that were unavailable in the state planned system or that could only be purchased in very small quantities, in a rationed manner. In other words, *the second economy* helped in reducing the scarcity of consumer goods and directed all the political frustration of the society towards pursuits

that would not have endangered the communist system (small acts of corruption, swindling, etc.) (Sampson, 1987, p. 120)

Although the economic system was centralized, the entrepreneurial role was most of the time informally and unlawfully exercised by the managers of state-run companies, individuals that had acquaintances (*tolkachi*), workers, consumers, farmers and peasants. In fact, the entire entrepreneurial activity can be catalogued as a manipulation of the centralized state policies and of the individuals that were included in the administrative apparatus (Prybyla, 1987, pp. 97-98). Although the secret services were a well-developed branch of the communist society, having spies everywhere, there was however a tolerance for such trades, particularly as these (workers in such services) would in their turn try to benefit from the goods and services that were unavailable in state-run stores.

One of the branches of the Soviet economy was *Sector C*. The activities carried out in this sector were outside the law, but they enabled private consumers to purchase illegally supplied goods on the black market (which was increasingly developed and well organized). Although it took on various forms, the goal was the same: to obtain a profit by taking the risk of conducting unlawful transactions. For instance, entrepreneurial individuals would purchase goods from point A and resell them in point B, but this was not a set rule. The most important aspect was related to the reselling period: the goods had to be placed with the final consumer within the shortest possible time from their purchase. Given that transactions would generally be carried out under the table, price formation was impacted by the location, time and contracting parties (Besançon, 2014, p. 77). To be able to have a competitive edge, speculators specializing in such transactions would get in contact with a reduced/limited number of state employees, that would provide them with the best information on demand and supply. Sometimes, this group would also integrate a distributor (O'Hearn, 1986, p. 9).

Informal entrepreneurship was based on *previous experiences, knowledge and their contacts* (Welter, F., Smallbone, D., Pobol, A., 2015, p. 9). *Blat* practices or the informal understanding was a means *via* which the Soviet economy worked (Ledeneva, 2008). The use of personal connections to cross the limits imposed by a defective system operated in parallel with the planned state, and this practice came at a price. The existence of price differences for the same type of goods, more exactly the price in the official system and the one on the black market, was justified by the risks undertaken by the entrepreneur. In general, the manufacturing costs for black market items were much smaller than those in the planned economy. However, the final sale price were very high, increasing marginal profits after costs elimination and risk evaluation (O'Hearn, 1986, p. 15). As there was a very small offer of consumer goods and services from the state sector, given the very low prices on the official sector, it appeared distortions that enabled the black market to expand.

#### 4. What you could buy

Although the socialist society is based on the coercion principle, the purchase of goods and services in the Soviet system was not very difficult if the potential buyers were willing to pay much more than the price in the official sector. Under such circumstances, one could purchase absolutely anything (Besançon, 2014, p. 77). As the planner fails lamentably, individuals in communist societies have to find another source to procure even basic goods. Most of the times, the origin of such goods was in violation of the legal provisions, and consumers use their informal connections to obtain necessary products, reducing the circuit of products by cutting down the number of middlemen (Ledeneva, A.V., Bailey, A., Barron, S., Curro, C., Teague, E., 2018, p. 61). The exchange of goods among Soviet states was a normal practice, particularly during the trips organized by the central authorities. Most of the times, their primary destination was Soviet Union states, but there were also exceptions when Western states could be visited. Irrespective of the destination, a fundamental requirement was for the applicant and their family to have a clean criminal record.

The adventure of purchasing (illegal) goods in the communist era cannot be overlooked, particularly as such a practice took on increasingly significant dimensions with the passing of time. The products that citizens purchased would most often include basic goods, necessary for a decent standard of living, but that the planners failed to provide. Below are a few illuminating examples prevailingly from the Romanian economy.

**Meat** was one of the foods for which queue-standing was a genuine challenge. Planners could not ensure the necessary quantity of meat; consequently, queue-standing for meat (sometimes for more than 24 hours) would at times end up in failing to purchase the long-awaited product (\*\*\*, 2003). By using personal connections and knowing influential persons, some individuals could obtain significant quantities of meat from restaurants, but the whole transaction was marked by a high entrepreneurial risk, naturally generating a very

high price, much higher than the one on the official market. However, there were cases where the black market price was half the price in the official sector, particularly when employees of the system would sell it in an underhand or unofficial manner (*under the counter*). Personal connections (the so-called “*acquaintances*”) tried to partially substitute the shortage of a product, irrespective of its nature. Exploiting such connections would be carried out in an informal manner, and entrepreneurs tried to purchase and use raw materials, machinery, workers, to set up connections with partners, distributors and consumers in a less risky manner (Ledeneva, A.V., Bailey, A., Barron, S., Curro, C., Teague, E., 2018, p. 61). The state’s attempt to substitute this basic food in the citizens’ diet was by offering much larger quantities of frozen fish.

During the communist period in Romania, **Kent** cigarettes and **coffee** were “*a different type of gold*”. Costing approximately 1/20 of a regular salary, most of the times one could use a box of Kent cigarettes to illegally obtain other goods and services (\*\*, 2003). Patients would most often offer cigarettes to their doctors to enjoy preferential medical treatment. Purchase thereof was also unlawful, and the price reflected the corresponding risk premium. Natural coffee was not intended for retail to the masses, therefore making way for a black market ready to leverage this entrepreneurial opportunity that never stopped to make its presence felt. Common people would wait in line to buy it, although it actually contained very little actual coffee with added chick pea. The coffee ration – ironically dubbed *nechezol* (*feed for horses*) – was approximately 200 grams. Delegations abroad were a great opportunity to purchase such scarce goods, and introducing them back into the country was achieved by offering gifts to customs agents (Todorova, 2014). For instance, people going to states such as Iran would purchase packs of coffee there and then resell them at whopping prices, thus capitalizing on the scarcity of the goods they tried to procure.

In communist Romania, **gasoline** had a constant price until 1980. Rationing gasoline became a phenomenon that evidently generated queue-standing. Vehicle owners had different pre-set shares of gasoline that varied from one county to another. People in Bucharest were entitled to 40 litres of fuel each month, while others in some counties were only entitled to 17 litres. Sometimes, the queues for purchasing fuel were more than 4-5 kilometres long, and the uncertainty of filling up the gas tank would never subside, as nobody knew the quantity provided by the state. Attempting to gain from this phenomenon, the gasoline sellers resorted to all kinds of unlawful practices, such as watering down gas tanks. In exchange for the gasoline sold under the table, they would receive money, products or other services. Thus, the entrepreneurial dimension had not disappeared, although the risks they ran were much higher. In order to reduce gasoline consumption, the authorities enforced a schedule that planned any trips made on Sundays. Thus, vehicles with even and odd license plate numbers could be used alternatively, every other Sunday. Gasoline rationing led to the generation of additional costs, meant to differentiate those willing to pay more for the scarcity of the product from those unwilling to do so. To reduce queue waiting time, some individuals would pay someone else to stand in line for them or would pay the seller cash to be informed about delivery dates.

The purchase of blue jeans, *Lotus* or *Fa* soap were deemed significant events. Most of the times they were of foreign provenance. For instance, the Polish people coming here on trips would bring products that were unavailable on the Romanian market. These were exchanged for money or national products that were unavailable in their homeland. Prices were well above the average of those sold on the official market.

*The informal economy* was a real phenomenon that occurred outside the limits of the law, but that was evidently tolerated throughout the communist era (Welter, F., Smallbone, D., Pobol, A., 2015, p. 3). The toleration of unlawful commercial trades had an underlying justification that was just as unlawful: the acceptance of goods and services by those granting the favour. The increasing level of welfare was significantly influenced by this aspect of the economic activities, revealing of a system that was unable to experience progress or economic development.

## 5. Conclusions

Communism enforced a new behaviour for individuals in former socialist countries within the sphere of influence of the Soviet Union. Evidently, the problem of the scarcity of resources could not be solved by central authorities *via* mandatory plans. The penury of consumer goods enabled the emergence and development of a black market, where informal entrepreneurship managed to satisfy a part of the consumers’ needs, in exchange for a fee.

Entrepreneurial activities were deemed “*crimes against the socialist economy*”. By means of such activities, individuals in communist countries tried to survive an oppressive regime, incapable to provide even the *basic*

*goods*. Most of the times, the purchase of goods or services was rationed by resolution of the central authority. Although this period was marked by restraints on individual liberties, the entrepreneurial part of human action was not completely stifled. The planners' failure in allocating scarce resources was without a doubt. The entrepreneur's role was to remedy the anomalies of this process, considering the fact that entrepreneurs are in fact *the driving force of the market*.

Issues related to space and time marked up the price of goods and entrepreneurs had to be able to identify the market segments where they could (illegally) sell goods to make a profit. The entire activity was marked by a high entrepreneurial risk, and the estimated profit from the transactions between individuals would stimulate resuming the whole process. Leveraging the so-called "acquaintances" or informal personal connections with individuals in the administrative apparatus proved to be the key to success for the informal entrepreneurs in the communist era. From this point of view, the corruption was the informal method for solving problems in terms of scarce resource allotment in an economic system with immense anomalies.

Tacit agreements between individuals have certainly favoured entrepreneurial activities in the communist period. The need to step up to the challenges and limits set by the regime developed an increasingly accentuated dimension of entrepreneurship by means of risk-taking and dealing with the uncertainty of the black market. The oppressive system could not stifle the individuals' entrepreneurial behaviour in spite of having restrained many of the liberties enjoyed in free societies. Despite becoming illegal and subject to criminal penalty, the entrepreneurial activities proved that individuals try to preserve a behaviour consistent with the free market even under the circumstances of a centralized economy.

## 6. References

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