

The second economy under socialism and capitalism

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Introduction: why we need a better understanding of the 'Second Economy'

The term 'second economy' is generally understood to refer those activities that, while obviously economic, fail to fit into the pattern of the main economy. This paper will argue that Heterodox economists should pay more thought to the 'second economy' both in theory and as the object of practical policy.

Currently, the term 'second economy' in economics is comparable to vocabulary used in Seventeenth Century medicine such as 'apoplexy', 'ague' and 'phthisic'. That is, while it refers to something that undoubtedly is going on, it is a portmanteau term that packs in a number processes without clearly distinguishing one from one another. This lack of precision makes it a blunt instrument for analytical purposes. We need sharpen it up for three reasons:

- a) 'Second economy' activities have played a significant part of economic life, not just in the developing world, but in major industrialised countries such as the Britain, United States and the Soviet Union. These activities were linked to the primary economy and interact with it. Our understanding of the history of real economies is incomplete without an analysis of the role of second economy activities.
- b) The second economy is not going away. While some second economy activities are survivals of previous historical periods they are not all fading away. On the contrary, some second economy activities in the developed countries are growing.
- c) The 'Second economy' is not a static phenomenon. The relationship between the primary economy and sections of the second economy is changing. In part, this is a by-product of the current economic crisis, though longer-term trends are also a factor.

Improving our understanding of the second economy is not just an abstract academic exercise. It has practical implications in two areas of concern for Heterodox economists.

The first concerns our struggle with mainstream economics. Orthodox economists do not entirely ignore the second economy. Gary Becker, Dubner Stephen and Steven Levitt tacked non-standard activities to answer such questions as 'if drug-dealers make so much money, why do most still live with their mothers?' In doing so they have sought to subordinate the second economy to the concepts of neoclassical economics. So while they concede that "behavior is driven by a much richer set of values and preferences" than just money, it reduces people to 'welfare maximizers' by extending 'welfare' to include all behavior be it "selfish, altruistic, loyal, spiteful or masochistic."ⁱ While this may be scientifically dubious they have done a better job of explaining criminal and family behaviour than their fellow mainstream economists have done in accounting for more conventional economic phenomenaⁱⁱ (though this is hardly setting the bar very high). Given the success of books such as 'Freakonomics,' Heterodox economists need to counter the mainstream by producing their own account of such phenomena.

The second area of practical concern is economic policy. If we are to gain a hearing from ordinary people then we need to develop a credible alternative policy to austerity. There is considerable scope for developing practical alternative policies for the second economy because, being informal and not subject to direct control, such policies do not necessarily require state authority to be put into operation. Instead of trying to influence governments Heterodox economists can make a direct appeal to ordinary people to take action.

The second economy is not going away.

Over the last half-century or so the population of developed countries have become more integrated into the formal economy. This increase in economic activity rates has generally been achieved through increasing participation in the labour market (e.g. the United States where the employment-population rate was typically around 95 percent of the economic participation ratio). Two trends have fuelled these changes: the decline in small family farms and the movement of women out of the home.

More recently, economic activity rates have stalled and, in the case of the United States, even decline somewhat (from a peak of 67 per cent in 2000 to at 62.8 percent in May 2014). While some of this retreat from economic activity is due to demographic reasons ('baby boomer' generation born from 1946-64 reaching retirement age) this is not the whole story. "People have given up looking for a job, gone back to school, or sit at home with their parents, or do small jobs for 'cash' outside the radar of the taxman."ⁱⁱⁱ These are indications of the growth of second economy activities.

In Britain mass unemployment has been associated with an increase in part-time work, self-employment and the founding of small enterprises ('microbusinesses', defined as firms with 1-9 employees). As in the United States, millions of employees who are in part-time jobs^{iv} only have them because they are unable to find full time employment.^v

Between 2000 and 2012 the number of businesses in the UK grew by 27 per cent to reach 4.8 million. This contrasts with a 20 per cent fall in the number of 'large businesses' (i.e. more than 250 employees) from 7,200 to 6,000 over the same period). Almost all of these new enterprises are classified as 'small' (i.e. less than 50 employees). Three quarters of them have no employees. The majority of (62 per cent) are registered as sole traders.

While unemployment was relatively low during the post-war period up until the late 1970s, self-employment as a proportion of total employment was stable at about 7 per cent. During the 1980s it rose to a plateau of to around 12%. Since the start of the recession self-employment has increased to 4.4 million, that is 13.6 percent of the economically active population.^{vi vii}

This is despite the fact that self-employed workers in the UK earn less than employees. The recession has increased the disparity. Between 2007 and 2012 the earnings from self-employment dropped by a fifth in real terms. Currently self-employed workers in the UK earn on average 40% less than employees.^{viii}

The likely explanation for this increase in self-employment and small firms is that it is a reaction to the dearth of secure, full-time employment by large employers. Over million workers in the United Kingdom, 3-4% of the workforce, are on some form of zero-hour contract. Large firms (more than 250 employees) were four times more likely to make use of zero-hours contracts than small firms. While almost half (47 per cent) of large employers had some employees on zero-hours contracts only 12% of employers with fewer than 20 employees did so. (ONS business survey for January-February 2014).^{ix}

‘Second economy’ activities have an important history

In the Soviet Union of the 1920s had a large second economy. Following the Civil war the Soviet government had introduced the New Economic Policy (NEP) which that led to a variety of second economy forms of activity. The most important was small-scale peasant agricultural production that was sold in open markets. It also included capitalist enterprises, though these were under state supervision, and restricted within certain limits. The NEP was a conscious retreat by the Communists in response to the economic collapse caused by civil war. It was the subject of considerable debate by communists until it was incorporated into the mainstream, planned, economy through collectivisation in the period 1928 to 1936 when the period of the New Economic Policy was formally declared to at an end.

Contrary to popular opinion markets were never abolished in the Soviet Union. There was always a market for private consumption, however prior, to Khrushchev, its scope was limited to the peasant produce and services provided by urban specialists. This part of the ‘second economy’ was legal and respected as such. However, there was also another part based on misappropriation and theft from the primary economy. This illegal economy encouraged corruption. In the early 1960s instituted economic reforms decentralized planning and introduced some market mechanisms into the primary economy. This included some forms of competition between enterprises.

During the 1970s an urban second economy was allowed to develop so that it began to offer a parallel distribution network for goods produced by the official economy. It was officially ignored for decades and then encouraged by Gorbachev, with disastrous results.

Sharpening up the concept of the ‘second economy’

In the previous sections readers will have noticed that the term ‘second economy’ has been used to refer to several different phenomena. These include various types of marginal employment (e.g. casual ‘cash-in-hand’ work for householders, zero-hours contracts for large, sometimes transnational, employers, peasant agriculture and criminal activity. While all these are linked by the economic imperative to “earn a crust” they are too diverse to be the basis of a systematic analysis.

The guiding thread of Marx’s studies, his materialist conception of history offers a way of resolving this confusion.

Marx's point was that there is no such thing as society *in general*, there are only specific forms of society. Further, such forms were not the product of the whims of human beings but of material circumstance. So while any number of different societies were imaginable, only a few forms have actually existed.

"Are men free to choose this or that form of society? By no means." (Marx, *Poverty of Philosophy*:152)

"The first premise of all human history is, of course, the existence of living human individuals. Thus the first fact to be established is the physical organization of these individuals and their consequent relation to the rest of nature. .. Men can be distinguished from animals by consciousness, by religion or anything else you like. They themselves begin to produce their means of subsistence, a step which is conditioned by their physical organization. By producing their means of subsistence men are indirectly producing their actual material life."^x

Marx's drew a strong distinction between a 'mode of production' and a society as a whole (or 'social formation'). The former constituted the material base "the real foundation, on which rises a legal and political superstructure".

A mode of production is the way people relate to each other in order to produce (the relations of production) this in turn is bound up with the way they relate to the physical means and technology used to produce (the forces of production).

"In the social production of their life, men enter into definite relations that are indispensable and independent of their will, relations of production which correspond to a definite stage of development of their material productive forces. The sum total of these relations of production constitutes the economic structure of society, the real foundation, on which rises a legal and political superstructure and to which correspond definite forms of social consciousness.

The mode of production of material life conditions the social, political and intellectual life process in general. It is not the consciousness of men that determines their being, but, on the contrary, their social being that determines their consciousness."

It is obvious that, historically, different modes of production have coexisted in a single society. Marx's not only recognised this fact; the idea that modes of production could develop within a society. His view was that more productive modes tended to dissolve and displace older modes of producing. Over time, one mode of production would become dominant. However a new mode could grow within "the womb of the old society". Thus different modes might emerge and exist alongside each other. This was essential to Marx's view of revolutionary social change..

"At a certain stage of their development, the material productive forces of society come in conflict with the existing relations of production, or — what is but a legal expression for the same thing — with the property relations within which they have been at work hitherto. From forms of development of the productive forces these relations turn into their fetters.

Then begins an epoch of social revolution. With the change of the economic foundation the entire immense superstructure is more or less rapidly transformed. In considering such transformations a distinction should always be made between the material transformation of the economic conditions of production, which can be determined with the precision of natural science, and the legal, political, religious, aesthetic or philosophic — in short, ideological forms in which men become conscious of this conflict and fight it out. Just as our opinion of an individual is not based on what he thinks of himself, so can we not judge of such a period of transformation by its own consciousness; on the contrary, this consciousness must be explained rather from the contradictions of material life, from the existing conflict between the social productive forces and the relations of production. No social order ever perishes before all the productive forces for which there is room in it have developed; and new, higher relations of production never appear before the material conditions of their existence have matured in the womb of the old society itself. Therefore mankind always sets itself only such tasks as it can solve; since, looking at the matter more closely, it will always be found that the tasks itself arises only when the material conditions of its solution already exist or are at least in the process of formation.

In broad outlines Asiatic[A], ancient, feudal, and modern bourgeois modes of production can be designated as progressive epochs in the economic formation of society. The bourgeois relations of production are the last antagonistic form of the social process of production — antagonistic not in the sense of individual antagonisms, but of one arising from the social conditions of life of the individuals; at the same time the productive forces developing in the womb of bourgeois society create the material conditions for the solution of that antagonism. This social formation brings, therefore, the prehistory of society to a close.”
(<http://www.marxists.org/archive/marx/works/1859/critique-pol-economy/preface-abs.htm>)

This process by which social and economic systems evolve is based on the premise of improving technology. Specifically, as the level of technology improves, existing forms of social relations become increasingly insufficient for fully exploiting technology. This generates internal inefficiencies within the broader socioeconomic system, most notably in the form of class conflict. The obsolete social arrangements prevent further social progress while generating increasingly severe contradictions between the level of technology (forces of production) and social structure (social relations, conventions and organization of production) which develop to a point where the system can no longer sustain itself, and is overthrown through internal social revolution that allows for the emergence of new forms of social relations that are compatible with the current level of technology (productive forces). The tail starts to wag the dog, at some stage the tail becomes the dog.

Reinterpreting the second economy as a form of mode of production

Marx's account could be rewritten as a theory of how a second economy might develop within the womb of the old society. Social change occurs when a second economy supervenes on an old, primary economy. Alternatively, it might be more useful to reinterpret the concept of a second economy in the light of the idea of mode of production.

In this view, the primary economy could be seen as the dominant mode of production. This mode governs the general structuring of society including other forms of economic activity. Instead of talking of a 'second economy' as a single entity we could think in terms of a number of 'secondary' economic forms. These would be distinct modes of production that were subordinated to the dominant mode.

For example, we could posit a domestic mode of production in which production is organized directly, without the use of money, at the level of the household for the purposes of consumption within that household. This is a pre-capitalist mode that has survived all-but in a diminished form. Arguably the movement of women into the labour market is the result of capitalism 'mining' the resources of the domestic modes of production and displacing its products (e.g. cooked food, nursing) with capitalist commodities (fast food and commercial health care services).

Simple commodity production (including the provision of services) by tradesmen and retailers would be another pre-capitalist mode that survives in 21st Century developed economies in an attenuated form.

Public services on the other hand do not fit the image of a 'second economy' activity as the term is usually understood. However, under this new interpretation, they might be seen as the embryonic form of a potentially post-capitalist mode that is in the process of being subordinated not just to the needs of capitalist, but to the forms of the capitalist mode of production itself i.e. markets, profits etc. The introduction of private finance initiatives (PFIs) into the British National Health Services is an example of this process.

The above examples do not cover all the phenomena we have discussed. At least some of the remainder are best seen not as other, secondary modes of production but as forms of crisis of the primary, capitalist mode of production. Examples of such crisis forms would be the expansions of zero-hours contracts, the compulsory conversion of wage-workers into contractors and the effective exclusion of millions of potentially productive people from the primary economy.

Two implications for policy

Reversing privatisation

One of the defining features of an alternative programme to austerity must be commitment to reversing privatisation by ending contracts with commercial firms and setting up council enterprises to provide services directly. This is necessary because:

- Under privatisation both centrally and local government have become milch cows for business.
- Experience shows that contractors organise their operations so that they provide the minimum of service while generating the maximum profit for themselves. To prevent contractors from skimping requires complex contracts (entailing legal fees) plus a monitoring system that is independent of the contractor. These are not just problems for public bodies; private companies also suffer from 'contracting out'.

- By taking services back 'in house' allows an organisation much greater control and flexibility. This makes it possible to define prime objectives of a department as quality and 'value for money'. Staff can then work to provide the best service within a given budget.
- Commercial contractors are typically large firms. This means that even when they provide an acceptable service, the profits they gain leave the area. This is a loss to the local economy.

A policy for small businesses

Local shops, traders and artisans contribute directly to the community through their own spending. The presence of small businesses is also vital for vibrant high streets and parades. In addition, small business owners tend to live in the area where their businesses operate. This not only gives them a personal stake in making their area a good place in which to live, they also tend to spend their money there. This helps the local economy. In contrast the profits made by large firms leave the area for good.

Because they are small, local businesses are far more accountable to the local people to whom they provide services than are big businesses. When an enterprise is small, it can't afford to use advertising to manipulate its customers. They heavily rely on 'word of mouth' recommendations. This means you are more amenable to the needs of your customers and the community than a large firm.

The above factors provide the basis for the community integrating small business into a community, social economy that serves the needs of ordinary people rather than following the blind pursuit of profit.

A supportive local council could support local businesses and enable them to survive and prosper when challenged by multiple retailers and chain stores. Such support would include:

- Higher business rates for firms over a certain size so that business rates for small firms can be reduced
- Taxation of supermarket car parking spaces
- Access to loans from the Bank of Lewisham for SMEs
- Reduced rents for small shops on council owned sites.
- Development of co-operative enterprises
- Open access for small firms to bid for contracts for those intermittent council services which are not easily delivered in-house, eg cleaning curtains, catering
- Acknowledgement of the community role of local pubs, cafes and similar outlets
- Investment in basic infrastructure such as storage

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