

---

# Price Adjustments under the Table\*

# 2

DANIEL LEVY

---

## Contents

Notes .....	28
References.....	32

Based on first-hand accounts, this chapter offers evidence on corrupt price setting and price adjustment mechanisms that were illegally employed under the Soviet planning and rationing regime. The evidence is anecdotal, and is based on personal experience during the years 1960–1971 in the Republic of Georgia.<sup>1</sup> I offer explicit evidence on the economic corruption of Georgia’s markets and institutions by providing a detailed account of various kinds of illegal economic transactions and activities my siblings were engaged in. While these transactions usually included common types of corrupt economic activities such as bribe payments, embezzlement, and fraud, unfortunately sometimes dishonest acts of cheating, scams, rip offs, etc. also took place.

Georgia, like the rest of the 14 republics in the former Soviet Union, did not have a free market economy. Rather, the Georgian economy was a centrally planned command economy. That is, government officials and bureaucrats and the members of the Communist Party and its functionaries made the decisions regarding the products and services to be produced, how much would be produced, and for whom it would be produced. In Western style free market economies, in contrast, market forces, along with the flexible price system, are the mechanisms that determine the answers to these key questions. Given that market forces in Georgia were not allowed to function freely, decision-makers such as firms, families, and individuals had to find ways around the restrictions imposed by the centrally planned totalitarian economic structure and its inefficient price system in order to overcome the problems and limitations caused by these inflexibilities.

I was born and raised in Tskhakaya (when Georgia regained its independence from Russia, the town’s name was been changed to Senaki), a small town in the western part of Georgia, close to Kutaisi—the regional capital.

\* Reprinted from Levy, Daniel. “Price Adjustment under the Table: Evidence on Efficiency-Enhancing Corruption.” *European Journal of Political Economy*, 23 (2007): 423–447. With permission from Elsevier.

Three of my brothers worked at government stores, selling various types of clothing, shoes, fabrics, etc. The stores were all located in the local market, called *bazari* in Georgian. The bazari was physically set up as a big circle. In the center were the fruits and vegetables market, where local farmers from the outskirts of Tskhakaya would sell their wares. Around the circle, along the bazari's walls, various kinds of stores were scattered, such as hardware stores, clothing stores, barber shops, and book shops, as well as a few restaurants. In addition, there were designated areas for selling milk products, flour and related products, chicken and other meat products, etc.

The stores were all government owned and operated in a similar fashion. No private ownership was allowed or recognized. All goods and services were produced by government-owned factories and manufacturing plants or imported to Georgia by government import agencies. The prices of the goods and services were set by government officials. For example, the prices the barbers charged were set by government directives. Similarly, the prices of shirts, trousers, shoes, and other goods sold at these stores were also set by government officials. The proceeds from sales were forwarded to the government office. The employees of the shops were paid on a monthly basis by the local government salary payment offices.

One main problem with the system was the inadequate level of the salaries. Therefore, the workers had to find some source of supplementary income, and everyone found some way of doing it. For example, the Kolkhoz farmers would sell some of their produce at the bazari at the "free market" price, rather than sending it all to government storage facilities, which paid them a low fixed price, regardless of the quality of the produce. The market price typically was much higher than what the government regulators assessed. Therefore, the farmers who sold their produce at the bazari would pocket nice profits.<sup>2</sup>

Although the bazari's existence was legal and authorized, the individuals who came to sell their wares there had to bribe various officials because otherwise, given the lack of another market, they could be denied entrance to the market or just be harassed by nosy market officials and policemen. Thus, the bazari authorities would happily allow people to bring to the market any legal, borderline legal, or even illegal (e.g., counterfeit) merchandise, as long as they were properly compensated for it. The bribe payments could take various forms, but typically they would include a side payment (in addition to the official nominal fee) to the person at the entrance to the market, who exerted much power because he could deny entrance to the merchants or he could report them to the police. Also, there was a limit to the quantity of merchandise the sellers could bring to the market, and bribing the person at the gate was the only way of eliminating that barrier. Various bazari officials and controllers and often the policemen as well would go around

the merchant tables scattered in the bazari and collect their bribe payments, sometimes in cash but quite often in kind.

The employees at these shops and stores used various methods to supplement their miserable government-paid salaries, but most often they would inflate the prices of almost everything they were selling, often by as much as 200–300% above the official price. However, they could not pocket all the profit. Instead, they shared it with the store manager, who shared it with his supervisor, who shared it with the local police station staff, etc. This way, everybody in the “food chain” received his or her share with the implicit understanding that as long as everyone played according to the rules, there was no reason to disrupt this remarkably efficient method of income redistribution.

To obtain satisfactory medical care, bribes and other types of under-the-table payments in cash or in kind were necessary. For example, when I was about 11 years old, my older brother and I were sent to Tbilisi, the capital of Georgia, to undergo a tonsillectomy, a surgical procedure that was routinely done in those days to every child. When we visited the doctor’s office at the hospital, the first thing my brother did was to discreetly hand him an envelope, saying, “Our parents have asked us to give this envelope to you.” The envelope contained 300 rubles. Georgian doctors never refused to accept these kinds of gifts.<sup>3</sup> Naturally, some part of these gifts likely ended up in the hands of the hospitals’ chief doctors and administrators.

Similarly, in order to enter an institute of higher education, payments to the “right people” were absolutely necessary.<sup>4</sup> Incredibly perhaps, bribing teachers was common even after entering the university. For example, students taking written exams would often put in their examination notebooks some amount (20–30 rubles perhaps) before handing in their exam notebooks. One of my brothers was able to improve his grades in his high school diploma after haggling with his teacher on the price. It turns out that the teacher was asking for 4 rubles for each extra point while my brother was only offering 2 rubles. In the end, they settled on 3 rubles per point. Thus, for example, improving a grade from 3 to 5 on a scale of 2 (“fail”) to 5 (“excellent”) cost my brother a mere 6 rubles.<sup>5</sup> My family members were not unique. As far as we knew, everybody was doing this. In fact, through word of mouth communication, people would often share with one another information about the market bribe rate (i.e., how much money a particular public official was taking).

Under-reporting and/or inflating the official prices and pocketing the extra income was the standard as well as the norm among the stores’ and shops’ managers and employees. Much of the merchandise these stores sold was produced by Georgian or Russian government manufacturing plants, although some proportion of the merchandise was often imported, typically from Poland, Czechoslovakia, Romania, Bulgaria, and other East European countries. Government officials, who typically were appointed directly by

the local or the regional (e.g., district level) Central Committees of the Soviet Communist Party, were in charge of setting the prices of the merchandise. They would set the prices without having any clue about the demand conditions in the market or about the costs of production or importation. In fact, the merchandise was almost always underpriced, giving the store employees powerful incentives to inflate the official prices and pocket the profits.

My siblings faced these kinds of situations on a regular basis. For example, a line of work shirts would arrive with the price tags attached to the shirt buttons. In addition to the price information, these tags would also contain information on the manufacturing date and place, washing and ironing instructions, etc. Now, with a price tag of 4 rubles per shirt, these shirts were grossly underpriced. Therefore, my brothers would order new price tags from a local government printing shop. The new price tags would be identical to the original price tags, with only one difference: Instead of 4 rubles, the tags would indicate a price of 10 or even 12 rubles. Then I, along with my younger brother, Joseph, would remove the original tags and replace them with the new tags. We used to inflate the official prices this way dozens of times each year with the delivery of almost every new shipment of merchandise.

Now, formally, the government printing presses were prohibited from printing any nonofficial government document, and certainly from printing *fake* price tags for *illegally* selling *illegally* manufactured products at *inflated* prices. Naturally, my brothers had to bribe the printing press managers—and especially their director—to secure their full cooperation.

The method of illegally obtaining goods and services in exchange for bribes functioned because everybody that was a part of the group or the circle received his or her share of the profits. The profit-sharing mechanism was designed in such a way that all participants had an incentive to play the game according to the rules. It worked precisely because everybody benefited and thus nobody had an incentive to disrupt its smooth functioning. High-ranking government officials, the police, and the managers at the store level were engaged in enriching themselves by dividing the surplus generated.

In the particular case of my family, following the unwritten profit-sharing rules, my brothers would share the 200–300% “profit” with all “club members.” For example, if, on a 4-ruble shirt my brother made 8 rubles’ profit, then he would keep 1 ruble and give 7 rubles to the store manager, who would pocket 1 ruble, and 6 rubles would go to the director of the bazari. The director and his office employees would keep 2–3 rubles, and the rest would go to the local police station chief, who would share it further with his fellow policemen as well as with his supervisors in the regional capital.<sup>6</sup>

Often, the decision by how much to inflate the price was left for the last moment. I took an active role in this kind of instantaneous price adjustment, which was done under the table, literally. I was about 7 or 8 years old at the time. On Sundays, which were the busiest market days, I would go to help my

brothers because the market was full of shoppers, as families—many of them from the surrounding villages—came with their children to shop.

My brothers worked outside their stores, behind big table counters. These tables—perhaps about 3.5 meters long and 1.5 meters wide—were enclosed and thus were used for storing merchandise. The table counters were covered with merchandise for sale: piles of shirts, pants, socks, etc. Shoes would be scattered among these piles.

My job was to sit underneath the table (which was quite easy for me as I was skinny and small) and help my brothers make on-the-spot instantaneous adjustments of shoe prices. I was equipped with a simple metallic device with rotating sharp heads with numeric stamps that I could use to mark any price on the bottom of the shoe.

A customer would come and look at the shoes displayed on the table, which typically would be quite large or really small in size and would have no prices on them. The customer would ask if we had the shoes in size 43, for example. My brother would at first say, “No, we are out of them.” Given the constant shortage of goods and services, Georgians were used to this kind of answer.

However, most of the customers would also know that at this point, if you truly want the merchandise, you must insist that the seller recheck his inventory, since perhaps there is “one last pair” of size 43 shoes left. Based on how strong and how persistent the customer was in his or her request, my brother would guess the price the customer would be willing to pay (i.e., he would intuitively try to assess the customer’s price elasticity—the customer’s price sensitivity) Finally, my brother would bend and “start looking” for the appropriately sized shoes under the table. I already had the shoes ready as I could hear the entire conversation, and my brother would whisper to me the price that he wanted me to mark on the shoes. Within a few seconds, he would be done searching for the shoes and, luckily, he would find “one last pair” of the requested size.<sup>7</sup>

My brothers were also engaged in buying and selling of counterfeit merchandise. The merchandise would be illegally produced by the same government production facilities that produced the “official” merchandise. However, unlike most of the counterfeit merchandise that one may purchase, for example, at the New York’s “counterfeit alley” along Broadway in midtown Manhattan, the quality of our counterfeit merchandise was identical to the quality of the original.<sup>8</sup> For any practical purpose, therefore, the officially manufactured merchandise and the counterfeit merchandise were identical. The only difference was that the production of the counterfeit merchandise would never be reported and thus, as far as government officials were concerned, they had no knowledge of its production.

My brothers would purchase the merchandise from the manufacturing plant employees at a low cost. For example, an exact duplicate of officially produced shirts with an official consumer price tag of 3 rubles could be pur-

chased illegally for 0.50–1.50 rubles, depending on the quantity purchased, and could be sold for as much as 8–10 rubles. For the manufacturing plant employees, these were very profitable transactions, as they pocketed all the revenue they obtained from these transactions but incurred no cost, essentially stealing from the government-owned factories. Obviously, they had to incur the overhead cost of bribing the higher level management and government officials.

Thus, my brothers' store would receive an official delivery of 50 shirts, for example. If these shirts were popular, then my brothers would purchase and sell as many as 500–1,500 counterfeit copies of the shirts within 2–3 weeks, while the official merchandise would remain on store shelves, most of it unsold.

To inflate the official prices more easily, my brothers would often create artificial shortages. The creation of artificial shortages was typically limited to products that were especially popular, such as imported clothing (e.g., shirts, pants, shoes, etc. from Czechoslovakia, Poland, and Hungary), imported food (e.g., Hungarian- and Bulgarian-made canned food), and some domestically produced products that were in constant shortage.<sup>9</sup>

Galoshes are a good example of a domestically produced product for which demand was always high and that was constantly in a short supply. Galoshes are overshoes made of rubber and were popular during rainy winter days, especially among the peasants and villagers, who would often use them as ordinary shoes for working in the field or for walking on the unpaved roads of their villages because they were unable to afford real shoes.

Supplies of galoshes would arrive at the store two to three times a year, and there was always a huge demand for them. People would hurry to stores asking for galoshes but on my brothers' table counters they would find only a single left shoe or only a single right shoe, and when they would ask whether there were galoshes of size 3 or 4 or 5, they would receive a very typical answer: "No, we are out of them."

If they insisted, however, then my brother would give them a hint: "Well, I do not have any galoshes left, but I can send my little brother to another store, and he might be able to obtain a pair of galoshes of the size you want, but the price will probably be 8–10 rubles. Also, you will have to give the boy 2–3 rubles as a gift." They would always agree to the terms of this deal. Of course, I would always manage to obtain for them the right size galoshes in 5 minutes, often with a profit of as much as 400–500%. The buyers were happy to receive the galoshes, even at the higher price.

Taking advantage of human temptations was a norm in Georgia. For example, when the store received a delivery of cheap plastic wallets, my brother would put just one wallet on the edge of his merchandise table, making it appear as if it had been left there by accident by one of the shoppers. Customers approaching the table counter would notice the wallet and indeed

assume that it was left accidentally by one of the shoppers. My brother would pretend that he had not noticed the wallet. In this type of situation, many customers would pretend that they were looking at the merchandise, quietly pick up the wallet, and put it in a purse or in a pocket. At that point my brother would politely inform them: "Sir/Madam, the wallet you just took costs 6 rubles." Most of the customers would pretend that they intended to buy it and pay the outrageously high price, as otherwise they would be admitting that they were thieves.

The profit-sharing arrangement my brothers had with the government authorities was in some sense a form of tax payment arrangement, where my brothers paid tax on a regular basis on the profits earned on every item sold.<sup>10</sup> This was a variable tax in the sense that the tax payments were linked to the quantity sold: the greater the quantity sold at the inflated price was, the higher the tax payments were.

There was another taxation mechanism that was quite popular in Tskhakaya, which was more like a fixed tax. This tax collection mechanism was implemented by the local police force in the form of periodic raids they would conduct on shops, stores, and other businesses. The police would come and, given their knowledge of the illegal activities that were taking place at these establishments, they would look for a "smoking gun." For example, they would look for items with inflated prices. When these raids occurred, the store manager would quickly organize with the store employees and they would instantly collect money to bribe the visiting police officers. The sums would range between 600 and 800 rubles.

There was another mechanism that was often used with the same goal in mind. A policeman would pick a customer whom my brothers would not suspect. The customer would be sent to my brother's store (*ducani* in Georgian) to purchase a product for which the price was inflated. The customer would buy such a product and leave, but later he or she would return with the purchased merchandise, accompanied by the policeman. On one such occasion, one of my brothers saw his customer was approaching him holding the blouse she had purchased just minutes before, and she was escorted by a policeman. Instinctively, he ran away and managed to leave the bazaar's grounds despite the police's attempts to quickly seal the market and capture him. It turned out that this particular policeman was an honest policeman, a true Communist, an incorruptible policeman (an oxymoron in Georgia!). My brother, therefore, had to go in hiding for several weeks while the police were searching for him. In parallel, my father was trying to influence this policeman through other (corrupt) police officers. These policemen were paid 1,500 rubles (which was considered a very high price) to convince their fellow police officer to stop chasing my brother.

A raid of a similar type took place at an illegal shoe manufacturing facility where one of my brothers was working. The business was located in a residen-

tial neighborhood and it was producing men's and women's shoes. The shoe materials were pre-cut somewhere else and at this facility the shoes were manually assembled by about a dozen workers. This was an illegal operation because in the USSR nobody was allowed to engage in private manufacturing.

In 1966, when my brother was 23 years old, the shop was raided by the city's chief investigative policeman. The policeman came to the shop with a large truck and loaded it with all the materials and merchandise that he found in the shop. However, my brother as well as several other employees managed to escape. He went to a friend's house and from there to the train station and there he took a train to my aunt, who lived in Suhumi, the capital of Abkhazia. There he stayed for 3 days, until he learned that it was safe to return home, which meant that bribes were paid to the right people—in this case to the chief investigative policeman. Upon his return, my brother learned that the raid was the chief policeman's personal initiative, a part of his annual "tax collection tour" for the welfare and well-being of his family.

One of the most remarkable things about Russia, and perhaps about the rest of the USSR, was the unusually high purchasing power of homemade vodka (*chacha* in Georgian). My father, like other Georgians, used to make chacha from the remains of grapes, after making wine from them. The quality of chacha was determined by pouring it on a plate and throwing in a burning match. If it caught fire, then it was of a high quality. In other words, it was a pure alcohol, no different from after-shave.<sup>11</sup>

Now, with such homemade vodka, one could obtain in Russia everything and anything, from domestically grown produce to imported consumer goods to machine guns.<sup>12</sup> We discovered that with homemade vodka we could accomplish a lot, even in Georgia. One of my brothers, for example, paid two bottles of chacha to his school teacher to have his high school diploma grades improved. In 1970, my father used 4 liters of homemade chacha along with 400 rubles to have our home connected to the town's electric grid, which, by the way, was supposed to be done for free.

To have one of my brothers accepted at an evening school, all my father had to do was to pay a late night visit to the school director's home and bring along 2 liters of homemade chacha. We sometimes went to a doctor's office with a bottle of homemade wine, although wine was not as popular as chacha as a means for making bribe payments, and thus its purchasing power was far lower. However, my father's homemade wine was considered pure (he never used any additives) and of a superb quality, and the entire town knew about it.<sup>13</sup> My father's homemade wine, therefore, was capable of helping us in many of our economic transactions. In particular, about 5 liters of it, along with a payment of 1,500 rubles to the Military Commissariat's officers, were sufficient for one of my brothers to obtain an exemption from serving in the Soviet military during a peace-time period. During war time, no amount of

money, vodka, or wine would help: Everybody would be mobilized for the Soviet military.

Religious practice was officially outlawed in the former Soviet Union. Instead, in Georgia as in much of the former USSR, Lenin, Marx, and Engels were the gods and their teachings (e.g., the *Communist Manifesto*) were the bible. Nevertheless, the city Jews somehow found a way to have the authorities allow the local Jewish community to build a synagogue. It was quite strange, however: The signs at the entrance to the synagogue indicated that it was prohibited to pray there. It was supposed to be a place for social gathering only.

We, however, practiced our religion and were able to hold regular daily prayer services at the synagogue because the local congregation collected money on a regular basis and arranged a generous bribe payments to the local city and police authorities. Thanks to small extra payments, they even permitted the families to bring along their kids to the Sabbath services.

In 1971 my family left the Republic of Georgia and immigrated to Israel. The process of obtaining the exit visa was full of hurdles and obstacles that, without side payments, would have been impossible to overcome. It began with an “invitation” from the government of Israel. The invitation was necessary for requesting an emigration permit.<sup>14</sup> The invitation was arranged through other emigrants who had left Georgia before us.

When the invitation arrived at the local post office, the post office director saw an opportunity for profit. This was the standard practice: Every time a letter came from overseas, usually from a family in Israel, the postman would come to our house and tell my parents quite directly and explicitly: “I have a letter for you from Israel. How much are you willing to pay for it?” Typically, one or two shots of chacha along with 50 rubles would suffice.

The value of an invitation from the government of Israel, however, was much higher than that of a single family letter. The post office director recognized this and took advantage of this profit opportunity, given his monopoly power over releasing the letter. In the end, it cost the family close to 600 rubles to obtain the document from the post office.<sup>15</sup> This, however, was only the beginning. The employees of the local office that issued birth certificates were unable to locate our birth certificates. However, a bribe payment of 150 rubles per certificate helped them locate the lost certificates.

Then there was a passport office in Tbilisi. There, we were sure that we would be expected to make a substantial contribution towards the happiness and welfare of the passport office head and his family. It turns out, however, that the person in charge was originally from Tskhakaya, a former star in the town’s soccer team. He recognized my father and my brothers and told them that he was not going to take any money from his “old comrades.”<sup>16</sup> That was a huge saving for the family.

The last encounter we had with Soviet authorities was in the city of Brest, on the border between Belarus and Poland. This was our point of departure from the Soviet Union to Israel. The Soviets did not allow emigrants to take with them many of their possessions. The border police in Brest, however, were more than willing to allow us to stuff the boxes we wanted to ship with anything we wanted, all in exchange for just one bottle of chacha per policeman.

In Georgia a person could only be employed by the government. No private enterprise was allowed. Even if one had a job that in the West would be described as self-employment, in Georgia he or she had to be registered at a government office, called *arteli*, which was considered his official employer. For example, my father and one of my brothers were registered with the local *arteli* as glazers. In theory this meant that the *arteli*'s officials could tell them what to do. For example, they could keep them busy by sending them to various government construction projects where glazers were needed. In addition, because the *arteli* was their official employer, they were supposed to receive their monthly salary from it. Officially, they were not supposed to sell their services to private individuals.

All these rules were only in theory, however. That is because, like most of the self-employed people, my dad had also bribed (quite generously) the *arteli*'s key officials, and therefore he was rarely called to government-run projects. In the rare occasions that he was called, he was rewarded by receiving fairly large quantities of uncut glass for his private business use. For example, periodically he would be called to a government construction project to install window glasses. These sites usually would have large supplies of glass, and the construction supervisors would often offer some of the uncut glass to him for private use because they would almost always receive deliveries of construction materials in excess quantities.

But, perhaps more importantly, thanks to the bribe payments, my father was permitted to sell his glazing services to private individuals quite openly. Moreover, he never reported his income to the *arteli*'s officials, despite the strict regulations that required full reporting of all incomes from all private transactions. In fact, each "self-employed" employee of the *arteli* was required by the Soviet labor and employment laws to hand in all the income he or she has earned from private transactions. That would count as his or her contribution to the benefit of the proletariat. In return, the employee would receive the government prescribed 30–60 rubles, the monthly salary.

Now, as far as we know, nobody ever handed in their privately earned income to the *arteli*. The entire thing was a big joke. The *arteli*'s apparatus was full of rent-seeking (i.e., profit-seeking) bureaucrats whose chief goal was to reach as many independent, self-employed individuals as possible to extract rents (i.e., bribes). My father, for example, would go to the *arteli*'s offices towards the end of each month and would report and hand in his 30-ruble privately earned income for the previous month. Needless to say, nobody

would ever question the accuracy of his reported income, which always was ridiculously low. In exchange, my father would receive his monthly 30-ruble salary from the arteli. Of course, the monthly salary payment from the arteli was quite minor in comparison to the actual income he regularly earned from his private glazing work. By the mid-1960s, my father got tired of these games, and with an additional lump-sum bribe payment, he obtained a permanent exemption from ever reporting to the arteli. Later on, he obtained similar exemptions for my brother and my uncle.

The cases and the events I have described are consistent with similar, although not as detailed, accounts offered by Simes (1975, 42), Simis (1977, 35; 1982), Grossman (1977, 25), Bergson (1984, 1052), and Hillman and Schnytzer (1986, 87). For example, according to Simis' (1982, 155–156) account, in order to have his business survive in Georgia, one Food Store Five's manager had to "*take money from the sales clerks, to sell goods at inflated prices, to cheat the customers, and, of course, to bribe the top people in the municipal administration, and all the store's suppliers*" [my emphasis]. This description summarizes quite well the types of activities many Georgians were engaged in, which suggests that the events I have described here were not limited to my immediate family members or to the time period this chapter covers. Indeed, the ways my family used to deal with the restrictions and inefficiencies of the Georgian economy were not unique in the sense that all of our neighbors and friends had to adopt similar methods and techniques to survive. The anecdotal evidence I offer, therefore, is quite typical and generalizes to behavior in Georgia.<sup>18</sup>

In Georgia's centrally planned command economy, the government officials and bureaucrats were the ones that made the decisions of what would be produced, how much would be produced, and for whom it would be produced. Thus, in Georgia, one of the main causes of corruption was state control over the distribution of the basic resources. The control manifested itself in the cumbersome and inefficient state management system, which made it impossible for individuals to obtain any service from the government without paying a visit to dozens of government officials in various offices. The state control over all economic decisions also resulted in constant shortages of goods and services. In the absence of free markets with flexible price and wage systems, Georgian decision makers had to find ways around the restrictions imposed by the centrally planned economic structure and its inefficient price system. In Georgia, therefore, the problems created by central planning were resolved, at least in part, by developing a black market, a parallel market where many goods and services were traded outside the official markets.

Corruption continued to exist in Georgia even after the collapse of the Soviet Union. The Georgian government did not begin taking serious anti-corruption measures until President Saakashvili rose to power in 2003.<sup>19</sup> According to Transparency International's corruption perceptions index, as

lately as in 2003, Georgia still was one of the most corrupt nations in the world—on a par with Tajikistan and Azerbaijan and outranked only by countries such as Myanmar, Haiti, and Paraguay. The corruption in Georgia seems to have a strong component of historical and social norms, which likely are contributing to the persistence of corruption in today's Georgia despite the recent political and economic reforms. The existence of these norms makes it unlikely that the corruption will disappear any time soon despite the current Georgian government's extraordinary efforts. Existence of these types of social norms, customs, and rules, therefore, suggests that Georgia and other countries like it could be stuck in a "corruption trap" for a while.

## Notes

1. Several existing studies explore the nature of corruption in the former Soviet Union and attempt to explain it as well as its economic consequences. See, for example, Simes (1975, 42), Simis (1977, 35; 1982), Grossman (1977, 25), Bergson (1984, 1052), Hillman and Schnytzer (1986, 87), and Levin and Satarov (2000, 113). For an analysis of corruption in the post-transition Russian Federation, see Levin and Satarov (2000, 113), who offer an interesting discussion of the institutional pathologies in the Soviet economy prior to the collapse of the USSR, which contributed significantly to the persistence of corruption in the republics of the former Soviet Union until recently. For a survey of the theoretical literature on corruption, see Aidt (2003, F632), who offers a detailed and thorough analysis of the existing theoretical models of corruption and possible causes of corruption, as well as its possible consequences.
2. Hillman and Schnytzer (1986, 87) and Grossman (1977, 25) also note that this phenomenon existed in the Republic of Georgia.
3. This kind of payment *prior* to the receipt of a medical treatment is perhaps different from the gifts medical doctors often receive (usually in kind but sometimes also in monetary terms) *after* a successful treatment (such as after a successful surgical procedure) as a recognition of a job well done. These types of postmedical treatment gifts are quite common in many countries, and it is unclear whether they should be considered a bribe.
4. The bribe rate for entering the university was in the range of 1,000–1,500 rubles. In addition, often a payment in kind was also necessary. For example, it was well known in our community that to purchase an admission to university, it was necessary to give a gift of *dvoika* (two-piece suit) or preferably *troika* (three-piece suit) to the university rector's wife. My parents often expressed regret and disappointment for

- not being able to send my brothers and sisters to the university. The necessary bribe rate was far too high for them.
5. Another brother used *chacha*—Georgian homemade vodka—to improve his high school diploma grades. Although *chacha* was sometimes used, money was still the primary means of bribe payments.
  6. Marjit, Mukherjee, and Mukherjee (2000, 75) suggest that existence of such strategic interactions between law enforcement agents on the one hand and the criminals on the other make standard anticorruption policy prescriptions quite ineffective. See also Klitgaard (1988).
  7. At least once I was arrested by the local police. My crime: illegally inflating the government-set prices. My punishment: a few hours of jail time, until my father came to the police station and paid 150 rubles along with 2 L of homemade *chacha* to the local police chief.
  8. See Confessore (2006, 1) for a detailed description of New York City's counterfeit alley.
  9. In Georgia, any product would sell at a premium regardless of its quality, as long as it had anything inscribed on it in any foreign language (i.e., in any language other than Georgian or Russian). Imported goods, therefore, were among the most demanded products.
  10. These payments do not constitute an ordinary tax, however, as they would never end at the tax revenue office. Instead, they went to individual policemen and government officials for their private use and benefit, not for the benefit of the general public. Hillman and Schnytzer (1986, 87) refer to these types of payments as “overhead expenditures” or “overhead costs.”
  11. According to a recent report in the Tel-Aviv edition of the *International Herald Tribune*, Iranians, like the Georgians, have been producing, bottling, and selling homemade vodka and wine for centuries. It turns out that despite the increased attempts by the Iranian authorities to enforce the existing laws that prohibit the consumption of alcohol, Iranians apparently are consuming bootleg homemade vodka and wine in increasing quantities. According to the article, some young Iranian entrepreneurs are even engaged in the highly risky business of delivering the outlawed drinks on scooters to their clients' homes, which points to the universality of the laws that govern humans' responses to incentives. See Fathi (2006, 1).
  12. A common perception in Georgia was that *chacha*'s purchasing power in Russia was far greater than in Georgia. We discovered in 1971 that this was indeed the case when we were leaving the Soviet Union. On the way from Georgia to Tel-Aviv, we passed through Moscow and later through Brest, and we discovered that we could accomplish so much more in these two cities by using *chacha*—substantially more than in Georgia. For example, various types of bribes that we had to make in

“chacha units” in Russia were much lower than in Georgia for similar kinds of goods or services. The main reason for this discrepancy in the vodka’s purchasing power was the Russians’ love for vodka. They valued it far more than Georgians. For Georgians, wine always ranked first. The purchasing power of vodka, therefore, was far lower in Georgia than in Russia.

13. We used to make the wine at home, which was allowed because it was a form of private activity, no different from home cooking. The men and the boys of the house would wash their feet, while the women would wash the grapes. Then, the men and the boys would jump into giant pots and trample the grapes. The resulting grape juice would be kept in jars for 4–5 years, while passing it through a periodic filtering process using simple cheesecloth. After 5 years, the wine would be ready. During a visit to Tel-Aviv’s Museum Haaretz, the tour guide explained how Byzantines used to make wine. The guide was amused to hear that we used to make wine in Georgia “the Byzantine way” as recently as 35 years ago.
14. According to a recent report of Human Rights Watch ([www.hrw.org](http://www.hrw.org)), the former republics of the USSR have almost completely eliminated the need to obtain an invitation from a foreign government to travel abroad or to emigrate.
15. Because the post office director was a monopolist in this case, the “price” we ended up paying for the invitation letter primarily reflected my family’s ability to pay.
16. This is similar to the “identifiable victim effect” (Loewenstein, Small, and Strnad 2007; Small and Loewenstein 2003, 5), which predicts that a greater sympathy will be shown towards identifiable than statistical victims. In the case of Georgia, it appears that it was acceptable to cheat or to steal from someone whom you did not know in person. Social norms, however, prohibited acting dishonestly with people whom you knew in person.
17. A reader might have the impression that, given the sophisticated schemes, cheatings, rip offs, etc. in which some of my family members were engaged, our family must have been quite wealthy. The truth, however, is quite the opposite. Most of the income the family earned was spent on food and other necessities and not much was left for anything else. That is primarily because we were a family with 10 children. Consider the following: unlike our neighbors, we did not have running water (which means that we did not have showers, flushing toilets, etc.). Also, unlike our neighbors, we did not have a refrigerator, a washing machine, a gas burner, an electric oven, a telephone, a TV (we often went to our neighbors’ houses to watch a soccer game on TV), or any other standard home appliance. In fact, we did not even have electricity until

1970, about a year before we left the Soviet Union. Until then, we were completely dependent on candlelight and kerosene lamps. We rarely purchased new clothes. As far back as I remember, I always wore my older brothers' clothes. They also wore used clothes, which came from various second-hand sources (e.g., wealthy families). We always purchased black bread because it was cheaper. We would eat chicken once a week and beef perhaps once every few weeks. Because rubber boots were too expensive, in cold Georgian winters we often wore galoshes, which were very inefficient when snow accumulated. For many years, we played using a homemade soccer ball because a real soccer ball was too expensive. Soccer shoes, which most of my friends had, were out of the question! None of my siblings attended an institute of higher education in Georgia because my parents could not afford it: The necessary bribe rate was too high. The family had to save all year long for my mother's annual summer trip to various mineral water sources because mineral water was considered good for diabetics. In short, our living standard was quite low, to say the least.

18. A reader might wonder why we behaved as we did. First, we had no choice. There was no other way a family could live and survive in Georgia without being engaged in these types of illegal activities. Second and perhaps not less important, it was the *norm*. Everybody was doing it, and that provided ethical and moral justification for our actions. Therefore, from the point of view of ethics, bribing, mark-up pricing, side payments in cash and in kind, and other similar kinds of black market activities were not considered immoral. To the contrary, they were considered perfectly normal, a part of everyday life in the former Soviet Union. Even worse types of crimes, such as stealing, cheating, rip offs, etc., which would be considered ethically less defensible to most people under normal circumstances, were considered socially acceptable in Georgia as long as the thief had no personal knowledge of the person he was stealing from. Unwritten social rules prohibited stealing from people you knew in person, such as friends, neighbors, co-workers, etc. Georgian President Mikhail Saakashvili has said, "Georgia was a very corrupt country. Sometimes people don't believe that it was corrupt because it was part of culture" (National Public Radio 2004). Marjit et al. (2000, 76) make a similar suggestion: "It [corruption] is so pervasive that citizens in the developing part of the world have accepted it as a social rule." See also Ludwig and Kling (2006).
19. For example, according to the 1998 estimates of the Georgian State Department of Statistics, the informal (or "black market") economy contributes over one third of the country's gross domestic product (Tavartkiladze 1998).

## References

- Aidt, Toke. "Economic Analysis of Corruption: A Survey," *Economic Journal*, 113 (2003): F632–F652.
- Bergson, Abram. "Income Inequality under Soviet Socialism," *Journal of Economic Literature*, 22 (1984): 1052–1099.
- Confessore, Nicholas. "No-Name, Brand-Name or Phony: It's All Here," *New York Times*, October 9, 2006, late edition—final, sec. B.
- Fathi, N. "It's Hard to Kick a 7,000-Year-Old Habit," *International Herald Tribune*, April 4, 2006, Tel-Aviv edition, news sec.
- Grossman, Gregory. "The Second Economy of the USSR," *Problems of Communism*, 26 (1977): 25–40.
- Hillman, Arye, and Adi Schnytzer. "Illegal Economic Activities and Purges in a Soviet-Type Economy: A Rent-Seeking Perspective," *International Review of Law and Economics*, 6 (1986): 87–99.
- Klitgaard, Robert. *Controlling Corruption*. Berkeley, CA: University of California Press, 1988.
- Levin, Mark, and Georgy Satarov. "Corruption and Institutions in Russia," *European Journal of Political Economics*, 16 (2000): 113–132.
- Loewenstein, George, Deborah Small, and Jeff Strnad. 2007. "Statistical, Identifiable and Iconic Victims." In *Behavioral Public Finance: Toward a New Agenda*, ed. E. McCaffery and Joel Slemrod, 33–46. New York: Russell Sage Publications.
- Ludwig, Jens, and Jeffrey Kling. "Is Crime Contagious?" Industrial Relations Section, Working Paper No. 510, Princeton University, 2006.
- Marjit, Sugata, Vivekananda Mukherjee, and Arijit Mukherjee. "Harassment, Corruption and Tax Policy," *European Journal of Political Economics*, 16 (2000): 75–94.
- National Public Radio. "Georgian President Visits Atlanta." Georgian President Mikhail Saakashvili's interview with Elina Fuhrman, August 11, 2004, available at the Web site of Georgia's embassy in the United States, <http://www.georgiaemb.org/DisplayMedia.asp?id=355>.
- Simes, Dimitri. "The Soviet Parallel Markets," *Survey*, 21 (1975): 42–52.
- Simis, Konstantin. "The Machinery of Corruption in the Soviet Union," *Survey*, 23 (1977): 35–55.
- \_\_\_\_\_. *USSR: Secrets of a Corrupt Society*. London: Dent, 1982.
- Small, Deborah, and George Loewenstein. "Helping a Victim or Helping the Victim: Altruism and Identifiability," *Journal of Risk and Uncertainty*, 26 (2003): 5–16.
- Tavartkiladze, Levan. "Georgia Report for GEO Project. Georgia Greens Energy Group," Paris: Helio International Report, 1998.