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**WHEN DOES THE RUSSIAN SHIP COME HOME?
A CRITICAL ASSESSMENT OF THE RUSSIAN
PRIVATIZATION**

Maria Tsenzharik

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When does the Russian Ship come Home? A Critical Assessment of the Russian Privatization

Maria Tsenzharik

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Maria Tsenzharik
Saint Petersburg University
Economics Department
Chaykovskogo 62
St. Petersburg 191194, Russia

**Institut für Höhere Studien (IHS), Wien
Institute for Advanced Studies, Vienna**

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Abstract

This paper provides a critical view of the process of large-scale privatization in Russia. The author analyses the offered model of privatization and possible reasons of choosing it. The new owners of the former state property are considered. A large part of the paper is devoted to evaluating changes in the industrial structure of Russia.

Comments

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Introduction

The privatization process taking place in Russia now is not the single event in its economic life. Privatization itself just continues a chain of reforms aimed increasing efficiency of the Russian economy and accelerating economic growth. The succession of them is illustrated in table 1.

Table 1:
The History of Reforms in Russia, 1985–1992

Years	Non-financial Businesses	Financial Institutions
1985–1987	All enterprises are state ownership	State banking: Central Bank, Sberbank Promstroybank Vnesheconombank
1987	Small business: first cooperatives; Large enterprises: hozraschot rules	
1988	Liberalization of international trade; First joint ventures with foreign capital	First commercial banks
1989	Decree on Renting Relations	
1990		First stock exchanges
1991	Price liberalization	
1992–1993	Beginning of large-scale privatization	Investment funds Insurance companies Non-state pension funds

Most papers on privatization are analyzing the current flow of events and giving advices what to do next. Nobody is trying to doubt the direction of the process. Maybe, we should stop and glance back?

Why such a remedy as large-scale privatization was tried in seven years after starting reforms? Which model of economic life regulation and why was preferred instead of the command economy? Who at last has got a right to control the property? Do industrial enterprises better of when privatized?

We will try to answer these questions.

1 Market in Russia: What will it Look Like?

“O wild West Wind!”

P.B. Shelley. *Ode to the West Wind*

Problems of coordination and control can be separated into two broad categories (W. Carl Kester, 1992, p. 26): those associated with the separation of ownership from control (principal-agent problems); those associated with contractual exchange among separate commercial enterprises.

As all enterprises in Russia were state-owned, the State was a unique *principal*, and had to supervise enormous amount of *agents*.

Directive, or command, regulation dominated in our country. That type of regulation was considered as ineffective. To treat it, the following decision was made: to create new principles and even more- to make all people of Russia being principals. Was it successful or not, we will show in the chapter 2.

At the same time, all *linkages* between enterprises formed under the command economy were declared not to be rational, as only the market provides productive and allocative efficiency. Then the conditions for destroying all links were generated, and enterprises were left to establish new links under the market functioning. We will analyze this problem in the chapter 3.

Thus, privatization aimed to change the old mechanism of economy regulation for the new one. As Frydman and Rapaczinski (1994, p. 59) mentioned, there were three models of privatization proposals.

The first type, modeled after United States and United Kingdom, aims the creation of *viable stock markets* and a system of external financing of corporate investment. The behaviour of enterprises is supposed to be changed after evolving *market for corporate control*.

The second type, aims to create a system in which banks and other *financial institutions* play a crucial role in supervising corporate management and the financing corporate investment.

The third type, so-called spontaneous privatization, which is initiated by the present management and the labor collective. Under this way, the *present control structure* is preserved.

The model to be chosen has to meet the objectives pointed down. As we can see, the *Program of Privatization of State and Municipal Enterprises in Russia in 1992* set several targets, in particular:

- forming of the class of private owners which are supposed to support creating of the socially- oriented market economy;
- increasing of effectiveness of enterprises activity in the result of their privatization;
- creating of the competitive environment and demonopolization of the Russian economy.

As “many East Europeans see stock markets as the ultimate symbol of capitalist economy” (Frydman and Rapaczinski), the Russian Government decided to evolve the first model of regulation. Was it right decision or not, we intend to evaluate below, but now we would like to outline some special features of understanding this type of regulation.

First, we should note that due to the lack of market-functioning experience and the fast but non-deep spreading of market ideas, people paid attention to theoretical basis. The three cornerstones: general equilibrium, perfect information, rational choice were interpreted as an essence of the market economy. The classical papers of western scientists were studied (P. Samuelson, L. Walras, J. Hicks and others). Thus, accepting American macro- and microtheory, we have to consider a man as a “hard-nosed short-run profit-maximizer suspicious of everyone he deals with” individual (R. Dore, 1987, p. 227). However, it is not the problem of the former socialist countries only. As R. Nelson and S. Winter (1982) stated in the prologue of their book on evolutionary economics, the western science in most ignores realities of the life. Even intermediate economics just introduces additional assumptions to the models built on the same three cornerstones. No new philosophy is introduced.

Another view on the market economy was provided in Russia by articles and books like “Taxation (Accounting, Banking, Contracting) in US (UK, Germany, Japan)”. Such articles described the separate pieces of the “life under the market” without understanding both the system as a whole and its historical, geographical, political and institutional features. Thus, the oversimplified and partial understanding of the market economy was introduced.

Second, in any case, we cannot deny that for some reasons, American references on economics dominated in our country. So, we took many American things as patterns of the market economy. Also, Americans themselves have written and done a lot, when trying to help “poor East Europeans” to change their lives. The most wide-spread opinion concerned to the former socialist states and Russia in particular that “there are not many people in Eastern Europe with sufficient expertise to facilitate and supervise the introduction of modern production and management techniques” (Frydman, Rapaczynski, 1994, p. 29). That is why most foreign companies establishing their headquarters in Russia prefer not to place local specialists on the top and middle management positions. However, this strategy did not happen to be successful in all cases. The brightest example, in our opinion, is activity of the well-known **Apple** company in the market of Russia¹. During two years and a half of its being in Russia, this company couldn’t reach the same success as it had got at the world market. One of the main reasons of the failure was called the wrong organization of the dealers’ network. All the positions in this network were given to foreign specialists. Mr. David Krauskopf, the General Director of **Apple** office in Russia, considered it as a mistake. Foreign managers failed to take into account some specific factors of local demand as well as the peculiarity of institutional structure of Russian economy. Now all the main positions in the dealers network, except of the General Director, are occupied by Russian specialists.

The latter fact is concerned with the new field of marketing. One can say that the Russian personal working at the Apple does it effectively due to this company is private one, and private ownership is necessary for emerging the generation of entrepreneurs. There is a popular view that the real entrepreneurship never existed in the socialist Russia, because all the property belonged to the State, and the socialist directors managed a company while they were not its owners. However, it is not true. As I. Boyko (1994, p. 24) argues, entrepreneurship does exist not in the field of small business only but at the middle and large companies. One cannot deny that the top management employees of such large companies as General Motors, Siemens, Mitsubishi and others are real entrepreneurs, in spite of they are not the owners of the companies. Similarly, directors of large enterprises in the former Soviet union had

¹See: *Kommersant* No.11, 1994, p. 34–38.

to make decisions, control the enterprise and to be responsible for the results. No doubt, the work under conditions of central planned economy made impressions on their style of thinking. However, as I. Boyko stresses, it could be treated with time, and their professional skills as experienced managers must be used. At least, those managers of the “old guard” used to work at the sphere of industrial production which provides economic growth, while “new Russians” prefer to make money as intermediaries.

Furthermore, our country was open to accept any market ideas without unbiased evaluation of them. Such adherence to market ideas looks like the communist ideology, or even stronger. One of the most catastrophic problems faced by Russia was recognized the monopolistic structure of its economy. It was considered as almost the main cause of all difficulties. The decision to fight against it by all means was made at the Government level. The large-scale privatization was directed to the total demonopolization. The Antitrust Laws adopted in the United States in different years happened to be the Bible of privatization. No shortcomings or discrepancies were seen. Also, there was no time enough for detailed studying the principles of the Laws. However, we share the view that in the extreme case, they tend to fight for the “Adam Smith’s ideal of atomistic, price-based competition in markets characterized by free entry and exit”. (W.Carl Kester, p. 24). We aim to show in our paper that this approach to the problem of monopoly is not appropriate to industrial structure of the Russian economy, especially with the point of view of economic development and searching the way out of crisis.

Third, to understand clear the model of corporate governance we aspire to, let us consider the ownership structure of corporations in four leading countries (see table 2).

Table 2:
Ownership Structure of Publicly Listed Corporations in Selected Countries,
1991–92

Country	Banks	Other finan- cial inst	Non-financial businesses	House- holds	Govern- ment	Foreign
Germany	8.9	10.6	39.2	16.8	6.8	17.7
Japan	25.2	21.8	25.1	23.1	0.6	4.2
UK	0.9	59.9	3.6	21.3	2.0	12.3
US	0.3	39.5	–	53.5	–	6.7

Source: W. Carl Kester, 'Industrial Groups as Systems of Contractual Governance',
Oxford Review of Economic Policy, Vol.8, No.3

Now we just would like to pay attention to the column *Households*. As we can see, the percentage of individually owned shares of American corporations is significantly higher in comparison with German, Japan and British ones (53.5 vs 16.8, 23.1, and 21.3 percent respectively). That is why we think that it was very naturally for Russia (following the American principles) to choose the method of vouchers privatization, which aimed to provide an opportunity for every individual to get "a piece of the pie"². Thus, we considered the roots of the way we go through now. In the next chapters we will analyze whether privatization fulfilled the objectives stated.

2 Altering Property Rights: Successors of the State

Here we would like to show that the aim of creating the class of private owners by large-scale privatization was just declared. We will prove that at least a half of the people received vouchers have lost their power to control the property. We will show that a dispersion of the property dictated by the vouchers privatization was eliminated. We will show that ownership was consolidated in the hands of large investors, namely, financial institutions.

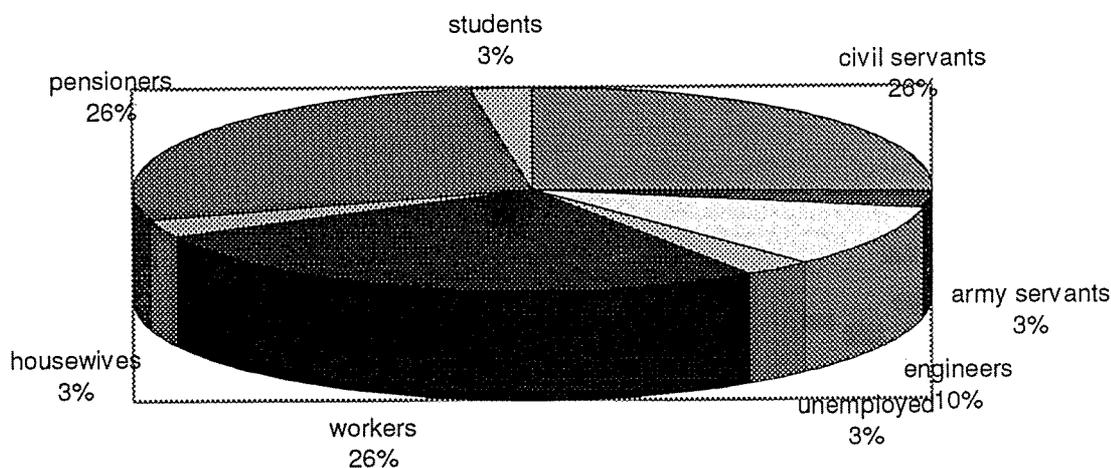
²see: M. Tsenzharik, 'Who will Enjoy the Pie?', unpublished working paper, 1993, CEU, Prague.

As it is stated in the Privatization Program (1992), in the result of privatization everybody is declared to get a piece of property or the money equivalent of this piece. Each voucher's owner had got the following alternatives:

- a) to sell it
- b) to use as a payment when participating in the vouchers auctions
- c) to exchange it for the shares of any Voucher Investment Fund.

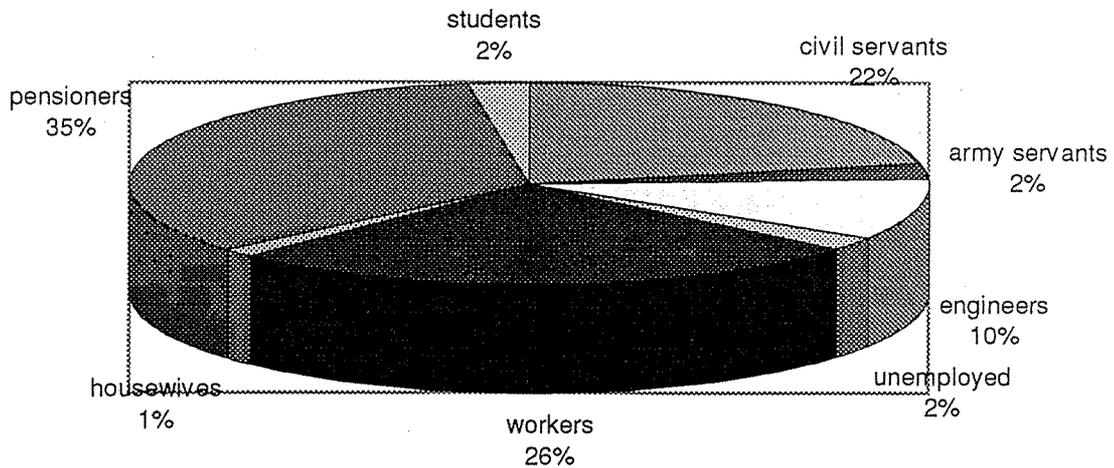
At the same time, workers of enterprises to be privatized, insiders, got privileges high enough to benefit from them. (Even in the case when an enterprise is not profitable, insiders became the owners of the fixed capital via vouchers and could gain from selling their shares to investors interested in possessing the control stake). Unlike them, outsiders or, more precisely, non-insiders³ have not got information enough for choosing an enterprise and participating directly in voucher auctions. Therefore, it is naturally to assume that are non-insiders who will entrust their vouchers to VIFs. Let us look at the figure 1.

Figure 1:
Distribution of vouchers
total = 511



³We define **non-insiders** as all people who are not working at any enterprise to be privatized. They might use their vouchers like we mentioned in the text. By **outsiders** we will mean such non-insiders who deal with concrete enterprise: are going to buy shares of it.

Figure 2:
Distribution of shareholders
total = 244



There is the distribution of shareholders of the Voucher Investment Fund⁴. Potential insiders are workers and, to less extent, engineers, whose shares count 26.2 and 9.8 percent respectively. Under the rough estimation, approximately only one third of shareholders of the VIF are potential insiders. Thus, we proved the idea that most shareholders of the VIFs are non-insiders.

Let us try to compute a share of people deposited their vouchers into VIFs. The total number of people which became shareholders of VIFs in Russia by 15 October, 1993 was approximately 28 million people (see table 3).

⁴Author's survey, St.Petersburg, 1993.

Table 3:
Voucher Investment Funds across Regions of Russia,
October 1993

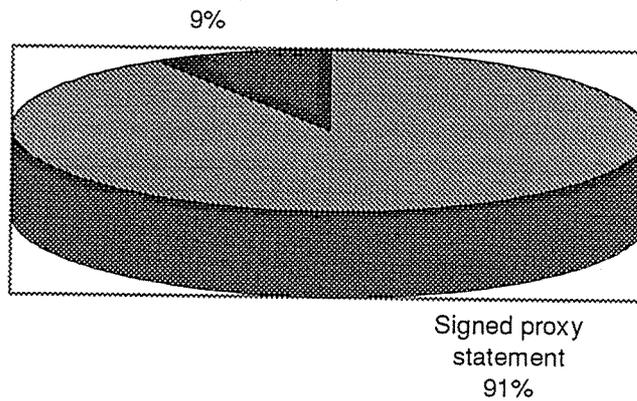
Region	Number of funds	Number of shareholders, thousand people
North	24	242
North-West	50	1,933
Central	171	15,050
Volgo-Vyatski	29	973
Central-Chernozyomni	22	543
Povolzhski	66	1,385
Northern Caucasus	48	1,251
Urals	68	3,508
Western Siberia	50	2,212
Eastern Siberia	36	842
Far East	33	678
Kaliningrad	1	4
Russia as a whole	598	28,621

Source: *Economicheskaya Gazeta*, No 47, 1993

A half of them, about 15 million people are the shareholders of VIFs of Central region (includes Moscow). It illustrates the fact that VIFs as the elements of the financial market are developing in the places of traditional economic centres with the communication network. The average number of vouchers per shareholder is varied around 2-2.5⁵. Thus, about 75 million vouchers were deposited into VIFs. These figures are not complete because the terms of vouchers' validity were prolonged till 30 June, 1994, so more people decided to connect their lives with VIFs by that day. This way or another, about half a number of vouchers issued was collected in VIFs. Usually a shareholder of a VIF was offered to sign a proxy statement. That proxy confirmed that a shareholder had given the right to use his vouchers to the Directors' Board. Such proxies were signed by 90.9 percent of small shareholders (up to 100 vouchers). As regard to relatively large shareholders (more than 100 vouchers), only 10 percent of them signed such a document (see figure 3).

⁵Author's survey.

Figure 3:
Small shareholders (up to 100 vouchers)
total = 308,000



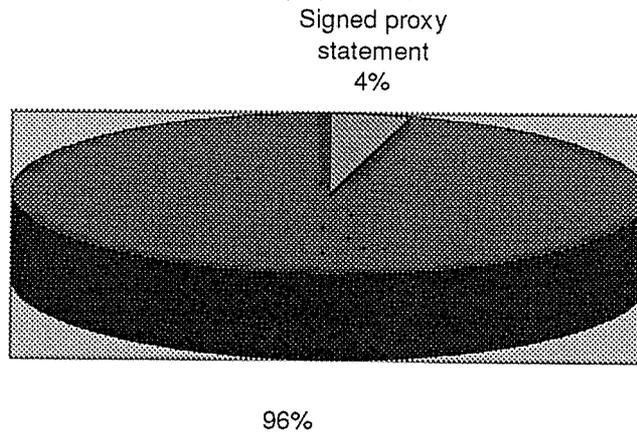
It is obvious, as an owner of the significant stake can actually control activity of the Fund and would not like to lose this right. Thus, we have estimated the number of vouchers and, consequently, the number of people who have lost their right to be owners as a half of total amount. To be sure in this number, we can include the quantity of vouchers collected by several "false" funds. Such funds accumulated pretty large number of vouchers and then disappeared ('Amaris' (St. Petersburg) -320,000 vouchers; 'Technicheski Progress' (Moscow)- 300,000)⁶.

One can argue that the shareholders of mutual funds that are widespread, for instance, in the US, have as rights with respect to the money they invested into these funds as ones of the VIFs' shareholders. However, as we know, according to the Charter of the mutual funds, their shareholders are given an opportunity to sell their shares to the Fund at any moment. By this way, they are able to return money invested in the case they are not satisfied with the benefits from such investments. Contrary, shareholders of VIFs have to await for the outcome their vouchers could bring.

The estimations we made are quite rough but they can be precised rather in the direction of growth. Thus, first of the main ideas of privatization by the method of vouchers, namely the creation of the broad class of private owners, have not been fulfilled. Consolidation of property in the hands of large institutions that could hardly be controlled by their shareholders took place.

⁶See: *Kommersant*, No.11, 1994, p. 39.

Figure 4:
Large shareholders (up to 100 vouchers)
total = 120



3 Industrial Restructuring: Does the Russian Ship Come Home?

Here we would like to consider another side of the problem of coordination and control, namely, the linkages among separate commercial enterprises.

3.1 Wrecking Giants: Intended Shipwreck

According to new ideas, the old economic system was completely ineffective in the sense of links between enterprises. The only way of solving this problem has been seen, to break down all the old links and allow to enterprises establishing new ones when evolving market economy. Simultaneously, process of changing monopolistic structure of the Russian economy was started. As the emerging of new firms that can compete with old ones takes long time, the policy of catalyzing process of breaking down business units into smaller ones was adapted. Now we will describe the process step by step.

The process of separation of single units started in 1987 when the Decree on Cooperatives was adapted. Such a form of enterprise was completely new for

the socialist economy. Financial control on new created cooperatives had been much weaker than one on existing state enterprises, especially with respect to the wages size. Although large enterprises were given more independence when coming to "hozraschot" rules, they were very inert for restructuring. Moreover, there was another cause why old enterprises remained ineffective. They have just changed the level of control. After weakening the central control, local bodies of government received practically unlimited power to control enterprises financially. Every Decree or Bill adapted by the Supreme Soviet or the Council of Ministers was accompanied by instructions of the local bodies. In most cases, those documents were more strict and powerful than original ones⁷. Therefore, cooperatives became almost the only form of activity granting relative financial freedom. Certainly, due to the lack of capital, cooperatives created couldn't themselves provide high technology or establish new production line. That is why about 80 percent of cooperatives were open at the large enterprises⁸. Some workshops and departments were separated from the parent plants. Partnerships were created out of departments and services. The Decree on Renting Relations (1989) identified conditions for such transformations. Cooperatives have as before been using all facilities of large companies: land, raw materials, personnel. As they targeted to help their parents to provide employment, salaries, flexibility, they rented land and equipment with the significant deduction in price. Actually, they were independent in the sense of financial control only. By the end of 1990, in Russia cooperatives amounted 134,594 units and 3,512,300 employees. They produced 7 percent of GNP⁹.

The next step which led to emerging more rubles of the old system was the well-known liberalization of prices in 1991. This Decree accompanied by the Law on an Enterprise, and the Chapter on Small Business in particular, led to significant increase in total number of firms in Russia. Thus, in 1991 industrial enterprises in Russia counted 28,023 units. However, in 1992 we can see 50,525 firms (see table 4).

⁷Once, in 1990, at the regional seminar in Suzdal (Central region), the author of this paper was giving lectures to the economists of enterprises. When explaining the fundamentals of the new Legislation, I found myself to be absolutely out of attention. However, a contemptible instruction document appeared in my hands won for me great respect. Everybody had been trying to look into and make a copy from it.

⁸See: *Russian Economy Yearbook*, Goskomstat, 1991.

⁹See: *Russian Economy Yearbook*, Goskomstat, 1991.

Table 4:
Ownership Structure of Russian Industry, 1992

Property	Number of firms	Number of firms percent	Industrial output percent	Number of employees thousand	Number of employees, percent
Total	50,525	100	100	17,495	100
State and municipal	26,105	51.7	85.8	14,583	83.4
Private	23,944	47.4	14.0	2,789	15.9
Public	476	0.9	0.2	123	0.7

Source: *Russian Economy Yearbook*, Goskomstat, 1993

As we see, almost all new created firms were private owned and belonged to small business: they produced 14 percent of industrial output and involved 15.9 percent of employees, although they numbered about 47 percent out of total.

Thus, we have seen that the Privatization Program has just continued the process started 5 years earlier. However, the first reforms entailed just separation of the large amount of tiny pieces of former state property. In any case, most small industrial enterprises were “fastened” to the core plants. The industrial bases, or framework, remained intact. Large enterprises belonged to the State and functioned as complexes. Moreover, linkages between large enterprises producing final goods (cars, equipment, food products) from one side and their suppliers and subcontractors from another side have not been broken. Contrary, the Privatization Program aimed to wreck monopolistic structure of the Russian economy. As Russia had a lack of capital and modern equipment, emerging of competitors faced certain difficulties. Then Russian Government had chosen the way of splitting capital of large enterprises. The favourable conditions for dividing them into independent business units were created step by step.

The Article 16 of the first edition of the Privatization Program (1991) contained just a paragraph setting that preparation of an enterprise to privatization means “... restructuring, including transformation of its parts into independent enterprises”. The Article 8 still allowed to form holdings out of joints (associations, concerns) of enterprises, if they do not lead to monopoly.

The second edition of the Program (1992) detailed the process of changing ownership. Specifically, for transformation of a production unit being a part of an enterprise into the single plant, according to that edition, it is enough to obtain a decision of its working collective and the local Property Committee. The consent of working collectives of other units of an enterprise is not necessary¹⁰. Moreover, that edition set a number of privileges in splitting to some industries. Thus, small businesses numbered 25,244 enterprises with 857.5 thousand employees by 1993.

The third step of privatization¹¹ not only made favourable conditions for separating, it even prohibited some association created before. According to the Program, they must be divided into separate enterprises and then to be privatized. Thus, the Article 5.18 said: "It is not allowed to create an open-stock JSC (including holding company) out of trusts, unions, associations and other groups, which include state or municipal enterprises." If they do, privatization of each enterprise separately must take place. It means that almost all association created should be divided again.

It was supposed that each enterprise will survive separately: to fight for investments, choose new technology, be restructured. By the end of 1993, 72 percent of small businesses (retail trade, catering, services) and 3/4 large and middle enterprises (produced 50 percent of industrial output) were privatized¹². However, economic situation does not seem to improve. First, 38 percent dropping in industrial investments is observed in the first four months of 1994: this index varies from 15 percent in Central region to 48 in West Siberia. This figures are correlated tightly with the volume of overdue debts (see table 5).

¹⁰The *Decree of the Supreme Soviet of Russian Federation* No. 2980-1, 11 June, 1992, Article 5.11.

¹¹*President's Decree*, No. 2284, 24 December, 1993.

¹²R in 1993.

Table 5:
Share of Overdue Debtors' Liabilities by Apr. 1994,
and Dropping in Industrial Investments (wrt Jan.-Apr. 1993)

Region	Share of overdue debtors' liabilities, percent	Dropping in industrial investments, percent
North	54	21
North-West	43	18
Central	34	15
Volgo-Vyatski	34	38
Central-Chernozyomni	51	32
Povolzhski	37	29
Northern Caucasus	44	29
Urals	46	27
Western Siberia	64	48
Eastern Siberia	48	33
Far East	58	39
Russia as a whole	48	38

Source: *Kommersant*, No.21, 1994

The total volume of non-payments was over 47 trln. roubles by the end of 1993. During this year consumer goods prices rose 9.4 times. Volume of international trade dropped by 10 percent, GNP – by 12 percent with respect to 1992¹³. Total unemployment, with involuntary part-time working, reached a point of 8.8 mln people (11.7 percent of the labor force)¹⁴. Up to date, qualified workers are about 5 percent out of the total number of blue collars (compare: in USA they are 43.5 percent)¹⁵.

3.2 The Market's Sea: Boats or Ships?

As we showed, industrial complexes as supposed to be ineffective were fractured into elementary units. It is obviously believed that now enterprises will immediately and inevitably start to establish the rational links only. The parts

¹³Ibid.

¹⁴See: *Kommersant*, No.21, 1994.

¹⁵See: *Smena*, 5 November, 1994, p. 2.

of the former monopolies are supposed to develop themselves for competition with each other; the plants of the technological complexes broken will join into another ones, no doubt, more effective. The market's billiards will place all the balls into their baskets.

An idea that the modern economy is based upon the single units, as well as the modern firm that consists of one enterprise, should be considered as nonsense, if it is not the simplification in some models. The firm as a network of factories appeared at the end of the nineteenth century as a cartel, then a trust. (for example: see A. Chandler, 1977). Introducing of new technologies and complicating of production process led to tightening links between business units. The degree of centralization of management changed by time¹⁶. Now the modern economy consists of trusts amounting dozens of enterprises and hundreds thousand employees. (Siemens- 360,000; Mannesmann- 120,000 employees). No doubt, middle and small firms are more numerous but less significant: in EC in 1988 the top 100 firms accounted for nearly 40 percent of GDP; in 1986 12,300 firms provided nearly 28 percent of total employment, represented only 0.1 percent of the total number of firms in the Community (see: S. Holland, 1993). As we recognize that the volume of R&D is such a parameter to determine the economic growth of the country, we must not deny that only large firms are able to provide funds and control use of them. Thus, as few as 12 major firms in central urban areas have absorbed up to 70 percent of given Community research budget, with insignificant sums allocated to smaller firms. (see: N.J. Chalmers, 1989). Moreover, those large firms grow over the national borders and become international: the number of *multinational companies* increased from 7,000 to 37,000 during the period 1970–1993. The number of their branch establishments abroad is 170,000 firms. Such large companies in oil, chemical, automobile and pharmaceutical industries assimilate 50 percent of all assets abroad¹⁷.

One could say that we would overestimate the influence of the large companies on the modern market if they functioned there separately. However, we would compare them with the knots of crystalline structure in metals, and smaller firms with free electrons which are moving around. It is a fact that the

¹⁶See: P.P. Lawrence and C.A. Vlachoutisicos (Eds.) (1990): *Behind the Factory Walls*, Harvard Business School Press, Boston, 21–35.

¹⁷See: 'Multinational Corporations in Japan', *Report of UNCTAD*, Delovoy Mir, 29 Sept. 1993.

large companies are connected with a number of other companies. Among all, these are their *sub-contractors*. For instance, Toyota Motor Corporation uses 36,400 sub-contractors, Siemens-30,000; Mannesmann-14,000; Bayer-17,500; Daimler-Benz- 16,600, BASF-10,000. (N.J. Chalmers, 1989). No doubt, the companies listed above belong to giants. In Japan, for instance, the average number of sub-contractors used by the large contractors is 67; in the precision machinery segment it is 132. Nevertheless, proportion of parts produced outside the major company (machinery, electronics, automobile industry) is quite high: 70-80 percent in Japan, 50 percent in US and 60 percent in Britain (Ibid). The sub-contraction links are long-term oriented. In spite of the firms-suppliers are juridically independent companies, in fact they are in most dependent on their patrons. They made their plans only after receiving preliminary plans of the major company. Due to their narrow specialization, small firms are not able to change their partners very easy. Of course this statement conflicts with the image of "Small is Beautiful"-firms. We shall however not overlook the fact, that we are confronted with a serious selection bias: Only those small firms overview in beauty, which demonstrate to be flexible. At the same time, such relations allow small and middle firms to be sure in their nearest future. Also, the patrons create so called price umbrella for smaller firms. We have to stress that such links between companies which generate opportunities for one side to control another one could in many cases be hidden. There are different forms of such a control: patent relations, agreements, strategic alliances, consortiums, etc.

Another form of links between companies leading to emerging large complexes is industrial groups. We just list the most famous: Deutsche Bank, BASF, Thyssen, Krupp (Germany); DKV, Sanwa, Hitachi, Toshiba (Japan), SHB, Volvo och Skanska, Gustavsson (Sweden). They can be bank-, family-, or industrial-centered. Companies inside them can be connected by crossed shareholding or long-term contractual relations. We see again that the activity of the firms belonged to such a group is controlled and coordinated from the centre. We have to stress once more that industrial groups are not wide-spread in the US and the UK. Let us look to the table 2 again: banks in those countries own less than 1 percent shares of corporations; non-financial business are not presented as shareholders at all in the US; in the UK this figure is negligible-3.6 percent.

Thus, we can conclude that there is another level of the economy which is different from macro- and microlevels. While macrolevel represents the economy as a whole, there are single firms at the microlevel. Such macrotools as regulation of demand, interest and exchange rate, taxation policy are used by the Government to influence the microlevel. However, large complexes we described above “make their own lives”. Use of high technology, complexity of connections, interdependency of units included, united management, orientation to the long run led to the situation that such large leagues are not affected effectively by the instruments of macropolicy. Among all, due to the fact that corporative plans or contractual relations in the industrial groups are designed for the long run, at least for 5 years. This is more than of the Government budget validity, or even the time between elections. Thus, we can speak of a mesolevel in the modern economy. We use this definition from Stuart Holland (1993).

3.3 Transaction Costs Explanation of the Issue

Here we aim to give some scientific basis for existing of large structures and explain the crisis in Russia. According to the Coase (1937) theory, one of the reasons of emerging firm and affecting its size are transaction costs. The volume of transactions between a producer or its suppliers or customers is analyzed. There are transaction costs connected with the market regulation of economic activity such as searching a partner, imperfect information and uncertainty vs ones concerned with expenses of administrative way of making decisions inside the firm. The boundary of a firm in a vertical chain of production will be determined by the balance between costs described above. Oliver Williamson (1985) deepened the concept of emerging large-scale companies.

Under the *command economy*, transaction costs of administrative regulation were enormous. Data collection, modelling, organizing systems of supervision in such a large scale led to the decision which was far from the optimal one. For that reason, the command economy was an ineffective system of control.

When trying to find a remedy, Russian authorities seem to have adopted the polar point of view, namely the *market regulation*. To reach it, we have broken down all links between enterprises and allowed them “free floating”. In the result, transaction costs of being a “market-player” were found to be

too high, especially, under inflation, weak legislative base and pervers financial structure. In pursuit of effectiveness, we have lost it and turned out ourselves at the verge of disaster. Thus, the golden mean was missed. When starting the privatization itself, objects, or, in other words, complexes of enterprises to be privatized should be distinguished.

3.4 Industrial Complexes as a Core of the Russian Economy

Most people in the West seem to imagine the command economy as something absolutely different from the market one. It is, as concerned to the state property, planning system and directive methods of control. Those categories as the immanent attributes of socialism were contrasted with the capitalist system both in economic and ideological sense. However, we have to recognize that these two systems have been developing, although in different ways, during a long time. Socialist economy, although being ineffective, had been functioning. Government of the USSR, as any Government of any country in the world, faced the problem of maintaining economic growth and supporting important industries.

The industrial structure of the Russian economy certainly differed from capitalist countries. At the same time, we argue that the core of the economy, namely large enterprises or their affiliates, had the **same structure** as it was in the developed capitalist countries. We argue that the inner arrangement of the modern corporation as a conglomerate of enterprises connected technologically, with its functional departments, production chain and the planning system, is **independent** on whether the economy is command or market one.

Let us return back to the command economy. The system of state control made boundaries of enterprises activity. At the same time, complexes of enterprises were economical units which functioned independently under conditions of the plan. Such joints of enterprises existed in the former socialist states: industrial *complexes* in Bulgaria, *kombinats* in Germany, *trusts* in Hungary, *centrals* in Romania, *concerns* in Czech Republic. Thus, in 1986 there were 46,178 industrial enterprises in the former USSR. Their number of trusts amounted to 4,294 and consisted of 17,190 business units. Those associations represented 9 percent of the total number of enterprises. At the same time, they produced

more than 50 percent of the total industrial output and accumulated 54.9 percent of employees¹⁸. Thus, we observe almost the same situation as in the countries with market economy: industrial production was concentrated at the conglomerates contained several enterprises.

We have to note that the inner structure of such association in most looked like one of the modern concerns. They had a Directors' Board, and other functional departments, and R&D Department. These complexes consisted of several business units. Some of them were vertically integrated. The factories and departments inside the concern were subjected to its administration. The Directors' Board used to receive a plan to be fulfilled. So, the top management was responsible for the concern activity.

The other single firms were coordinated by the large amount of branch ministries and departments. For instance, let us consider production of lifting equipment. The Ministry of Heavy Industry controlled 22 plants which produced 17 percent of the total output of lifting gears. The rest of them, namely 83 percent were produced at 400 factories which were controlled by 35 ministries and departments (Baryshnikov, Granatkin, 1988, p. 96). These bodies were very powerful when commanding "their own" enterprises. Also, those departments possessed information of the industry as a whole. Therefore they could apply and interpret laws and decrees of the Government according to their understanding of the issue. In our opinion, such *segments* of industries governed by the branch ministries were analogues of the concerns. The **crucial difference** was that their administration was subjected directly to the Government bodies. Hence, first, the Government had a right to intervene in their operative activity at any moment. Second, the ministries missed their own profit. All money flows operated by them had to be approved by the higher authorities. However, the inner structure of such segments had been formed for years and had to be maintained as stable one. Therefore groups of enterprises headed by the ministry or department should be privatized together.

We would like to direct your attention to the industrial structure of Russia which had formed by the end of 1991. Looking to the table 1 once more we remember that by that time renting relations had existed for one year, and prices stopped be fixed. When the system of branch ministries got weaker but before everything started to tumble down, a great deal of new structures

¹⁸See: *USSR Economy Yearbook*, Goscomstat, 1989.

emerged. Thus, at the end of 1991 we had got: 227 trusts, 123 consortiums, 3076 associations and 189 unions¹⁹. Some of them were in fact established. However, most of them just accepted new name and new image but represented the old structures. Indeed, there was not enough time to establish new links at all levels of such a hierarchy as, for instance, a trust. We tend to think that the groups of enterprises with stable business links tried to separate themselves as indivisible formations. They had to be kept in any case, to prevent technological links between plants to be lost. We feel strongly that it was very important step in restructuring Russian economy and its importance was not appreciated enough by the Government.

4 Conclusions

The process of maintaining links had been started by enterprises themselves. During primary placing of shares of new created joint stock companies, working collectives of them expressed an intention to make some preference to their subcontractors. However, no Government documents had been issued to support the process.

Then enterprises started to create their own structures. There are associations, alliances, holdings. As usual, enterprises included are not connected technologically. Nevertheless, some attempts of accumulating funds of participants and coordinating their activity through the common trade policy and pricing have been taken. We can refer to AVVA which is famous, as it is an alliance of automobile plants including *Avtovaz* (Tollyatti). *Lomo* (optics complex, St. Petersburg) could have kept itself as a trust.

In the end of 1993, the Decree on Financial-Industrial Groups in Russia was adopted²⁰. It defines the FIG as a group of enterprises, organizations, financial, credit and investment institutions. According to the Decree, such a group is formed for “uniting material and financial resources of its participants for raising competitiveness and effectiveness of production and establishing rational links between enterprises”. However, we consider creating such groups now as a problem, under distortions of inflation and non-payments. More sensible,

¹⁹See: *Russian Economy Yearbook*, Goskomstat, 1992.

²⁰President’s Decree No.2096, 5 Dec. 1993.

in our opinion, to stop breaking down large complexes directly and by this way to maintain the main centers of the economy. It is possible to do it by the command way, and practice proves it. Thus, according to the Privatization Program in 1994²¹, privatization of a number of industries is regulated by the special decrees of the President. Such giants as “Norilski Nickel”, “Gazprom”, “Lookoil” are privatized as complexes and are subjected to the Government regulation. Also, the Defence Committee intends to maintain war industry as a complex²².

Thus, we feel strongly that our economy could be helped by maintaining and supporting of the complexes based on technological links. We have to swallow a bitter pill, when recognizing that the market has changed since the times of Adam Smith.

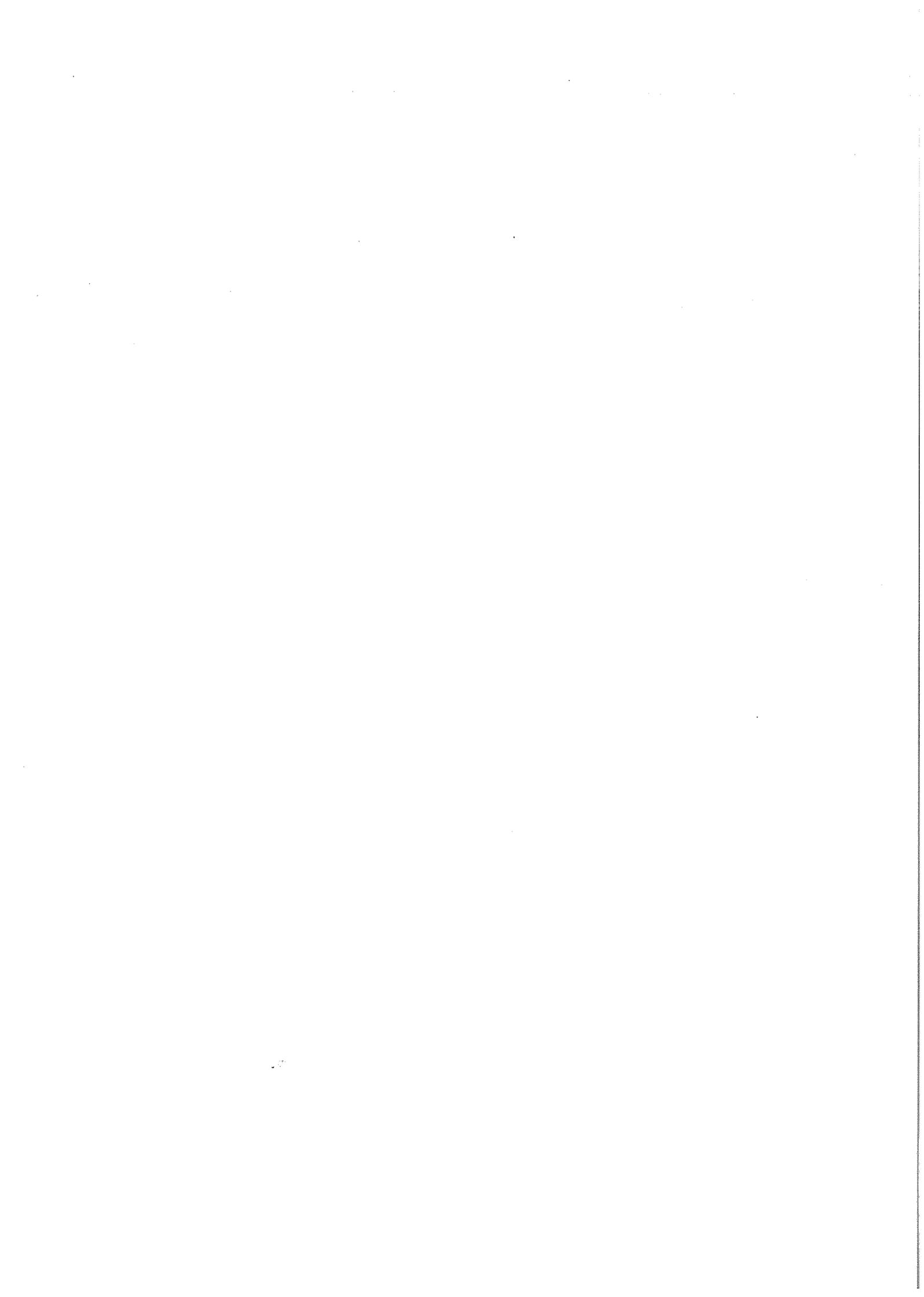
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²¹President Decree No. 2284, 24 Dec. 1993, Article 6.

²²See: *Kommersant*, No.39, 1994, p. 23.

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Institut für Höhere Studien
Institute for Advanced Studies
Department of Economics
Stumpergasse 56
A-1060 Vienna
Austria

Tel.: +43-1-599 91-149
Fax.: +43-1-599 91-163
e-mail: woergoet@ihssv.wsr.ac.at