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## 1. Introduction: Subject Matter of Economic Theory

It can readily be stated that economy as such has been subject to in-depth studies and economic theory has been developed quite well. Modern realities, however, especially post-Communist transformation processes have revealed a bunch of unsolvable problems. The goal of this essay is to distinguish and focus on one segment of the post-Communist economy, which not only has never been scrutinized by economic theory, but also has never been noticed by economists as a distinct phenomenon. To get an insight into the problem it would be helpful to give a brief overview of economic theory and its main components.

Human existence without consumption can not be imagined. What is necessary for satisfying one's needs, seldom can be found in nature in a "natural state". It is for this reason that one has to take resources (which, in turn, are limited in terms of both quantity and accessibility) and utilize them for the production of goods necessary for human consumption. This, in turn, can not work out well if both resources and produced goods are not distributed. That's exactly what is called *economy*. Consequently, economy is community's utilizing scarce resources for the production of goods to be consumed and distributing those resources and goods for the said purpose. *Economics*, i.e. *economic theory* is a social science the subject matter of which is economy.

Depending on who – individuals and private companies or the government – makes decisions on the matters of production and consumption, *market* and *command economies* may be distinguished. However, in the modern world, as such, neither of the above two exists any longer; because in reality decisions on the above matters are made by both individuals and entities and the government – each of which make such decisions within the bounds of their respective competence – all what exists is the *mixed economy*.

There is a special approach which has quite extensively been applied by researchers in studying economy as such. It is called a hierarchic approach. Traditionally it has been accepted to represent national economy as a two-level (consisting of lower and upper levels) arrangement.

At the lower level, subject to studies is the behavior of individual economic agents – namely households and companies – in the course of decision-making, as well as their impact on each other during the market relationships. This lower level of economy is known as *microeconomy* and the field of research which takes the latter as its subject matter is called *microeconomics* or *microeconomic theory*.

At the upper level, focus is placed on the behavior of national economy as an entire organism (which is reflected in economic growth, inflation, employment, external trade, etc.). This level, in turn, is called *macroeconomy*, while the appropriate field of research – *macroeconomics* or *macroeconomic theory*.

Whenever economy is viewed from the global standpoint, one has to distinguish another level known as *mega-economy*. Accordingly, *mega-economics* or *mega-economic theory* is the field of research which deals with international integrative processes, dynamics of the world economy and so forth.

In addition to these three classical levels of economy, which are known to every average economist, researchers have to set apart one more sphere of economic life which should be subject to a separate scrutiny. It is called “*shadow*” *economy*, a phenomenon which is present at all the three above-mentioned levels of economy.

By its nature, “shadow” economy amounts to economic activities of households and private companies that are beyond the government’s reach and control. That’s why shadow economy is primarily linked with microeconomy. However, because the said uncontrolled and unregistered economic activities

make a part of the entire national economy, outcomes of the shadow economy may have their direct influence over macroeconomic indices and may produce a wide range of depressing effects, such as drop of fiscal revenues, circulation of unaccounted monetary resources, decrease in export-import figures, etc. Due to the enlargement of the scale of shadow economy, it has turned into an international phenomenon: the practice that “black” money made in one country is “washed” in another is widespread in the modern world, which fact, eventually, needs to be subject to thorough scrutiny by megaeconomists.

Out of the aforementioned branches of economic theory, microeconomics and macroeconomics are the ones which have been developed better than others. Megaeconomics is a relatively new field. As per shadow economy and its exposure at the above three levels, it is one of the most topical and so far least studied problems facing the modern world.

## **2. “White Stain” in Economic Theory**

Post-Communist economy, among others, consists of such a sphere that up to now has never been subject to special consideration of the economic theory, as never before has it been recognized as a distinct area of economy. To identify that sphere, it would be necessary to call to mind what kind of material and technical base command economy rested on.

Generally speaking, command economy never recognized any form of competition either domestically or internationally. Instead, command economies were united in an integrated economic area (the best example to that was the former Mutual Aid Economic Council, which over the four decades of its existence, together with the Soviet Union had united such command

economies as Bulgaria, Poland, Romania, Hungary, Czechoslovakia, East Germany, Cuba, North Vietnam and Mongolia), within which any exchange operation used to be regulated by a central coordinating body. As per economic cooperation with market economies, up to a certain period, such a cooperation was totally impossible (in particular, before World War Two the Soviet Union had pursued an “Iron Curtain” policy in relation to the West), while later on it became possible, though confined to strict limits.

Under the rule of command economy, only a single form of competition was permitted, even though this permission was limited to the Soviet Union. I mean the competition with the West in the field of military production, which encouraged the Soviet Union to develop the production of nuclear and conventional weapons, explore space and so on.

The denial of competition forced command economies to reject the only effective stimulus of economic development. As a result, farms and factories produced low quality goods whose prices were artificially reduced at the expense of government’s subsidies paid out of the budgetary funds. Proceeds from the sales of alcoholic beverages were the main source of the Soviet national budget. The only way of getting foreign currency resources was the sale of minerals (primarily oil) at international markets.

As a result of analysis and generalization of essential features of the Polish command economy, Adam Lipowski comes to the conclusion that under the circumstances where the world is divided into “developed” and “developing” countries, command economies can not be attributed to either group. To characterize such economies, he invented a term “misdeveloped” and set out a number of features characteristic to the misdeveloped economies (Lipowski, 1998, p. 9).:

- (a) excessively high share of industry in GDP at the expense of domestic and foreign trade and financial and insurance services;

- (b) excessively high share of manufacturing of production inputs, at the expense of the production of the means of consumption;
- (c) insufficient share of internationally competitive goods in industrial production;
- (d) large scope of low-quality unwanted production imposed upon buyers;
- (e) excessive share of obsolete goods in industrial production at the expense of new and update products.

The collapse of the Communist regime and the breakdown of command economy “stripped off” the post-Communist economies vis-à-vis the international market: it turned out that with rare exceptions (partially hydroelectric power, mining, and primary processing of extracted raw materials) all goods produced in these countries were incompatible with international standards and could not compete with the Western products due to low quality and/or high prices. There is no market of such goods and there is no hope that such markets can ever exist. We believe that the economy of that type can only be referred to as “*dead*” economy, or “*necroeconomy*” (in the old Greek language *nekros* meant “dead”) (Papava, 2000), and the theory studying this type of economy – *necroeconomics*, or *necroeconomic theory*.

Adam Lipowski labeled the above-described process of “stripping” of command economy as “divestment” (Drucker, 1996; Taylor, 1988). By this, he meant the process in the course of which a “misdeveloped” economy divests itself of all the above “pathologies” (Lipowski, 1998, pp. 31-32). We believe that necroeconomy is an ultimate result of that process.

Naturally, even if a certain section of economy is “dead”, the other sections may be “alive”. For this reason, this section may be referred to as “*vital*” economy, or *vitaeeconomy* (in Latin *vita* means “life”), while the corresponding theory as *vitaeeconomics* or *vitaeeconomic theory*.

The very first question which may arise in this regard is what is the resemblance and difference between necroeconomy and vitaeeconomy.

In necroeconomy, like in vitaeconomy, production of goods, in principle, is possible. In other words, *supply*” is existent. However, unlike the goods produced in vitaeconomy, those produced in necroeconomy, because of their poor quality and/or expensiveness, can not cause any *demand*. Consequently, in necroeconomy no act of purchase and sale may be done and no balanced prices can exist.

The next question is no less important: if a certain segment of economy is dead, or in other words, if it can not be revived, seemingly one should not face any problem at all, because “dead” segment should not have any influence on a more-or-less healthy segment and, therefore, could be easily neglected.

Under the conditions of market economy that’s exactly how it works: non-competitive businesses usually “pass away” without doing any harm to the rest of economy. Perhaps this is exactly why economic theory, which, in principle, has always been concerned solely with the problems of market economy, has never paid any attention to necroeconomy: as there was no real threat from the side of necroeconomy, there was no reason for regarding it as a subject matter of economic research too.

The situation is essentially different in the post-Communist economies, which presently undergo the process of transition. The significant part of the material and technical base of command economies now have turned into a foundation on which necroeconomy rests. Most dramatically this process was reflected in the industrial sector.

### **3. “Routine”: Reproductive Base of Necroeconomy**

To explain mutual impact of necroeconomy and vitaeconomy on each other, it would be helpful to break the entire organism of post-Communist economy into the following pieces:

1. Necroeconomy existing in the public sector;
2. Vitaeconomy existing in the public sector;
3. Privatized necroeconomy;
4. Privatized vitaeconomy;
5. Private sector based on new investments – vitaeconomy.

The first group, as a rule, consists of large and medium enterprises which, because of their importance, are assessed as strategic objects, although their products are completely non-competitive which fact makes all these objects “dead” under the conditions of free market.

Energy sector (especially electric power generation, oil and gas extraction/supply), transport and communications comprise a vitaeconomic segment of public sector. If the privatization of any companies of these sectors takes place, than such companies may move to the fourth group referred to as “privatized vitaeconomy”. This group also consists of some medium and, more often, small industrial companies.

The third group consists of the former first-group enterprises after their privatization. The change of ownership itself can not result in the revival of frozen production, because what is “dead” can not be recovered whoever the owner of the dead may be – the government or a private company. It is for this very reason that the process of privatization is often discredited, as it (privatization), especially in its initial phases, in isolation from any investments, has often been assigned the function of reviver of the “frozen” production, without considering the question – this production is “dead”, or “alive”.

The fifth and the last group integrates the healthiest segment of the post-Communist economy: a new private sector based on new investments and principles of market economy. Despite this, one has to take into account the fact that this group also faces certain problems which need proper contemplation. In particular, I am referring to some foreign investments through which the post-Communist nations, instead of newest technologies, are swamped by outdated and old-fashioned (more precisely, morally depreciated, as compared to international standards) tools and equipment, which, I think, could be readily labeled as “*secondhand investments*”. Obviously, goods manufactured with such technologies can only be acceptable within the boundaries of emerging markets and just for a certain period of time, that is to say until the internationally competitive products invade such markets.

Another question which essentially needs to be answered is what is the reason for such a constancy of necroeconomy in the post-Communist countries. I believe that the evolutionary theory of economic change (Nelson, Winter, 1982) is the one, which could be applied to that issue in the most effective manner.

The main tool of the above theory consists in a concept of “routine”, by which the company’s customary rules and methods of behavior, which regulate the reproduction of the company’s activities, is meant (Murrell, 1992).

Exactly “routine”, which has deeply been rooted in the command economy over many decades, is the main factor that forces “dead” enterprises to work in a no-longer-existing regime of command economy. As a result, warehouses of those enterprises are flooded by poor quality goods and debts to the national budget, social schemes, energy sector and other enterprises, incurred because of inability to market such goods, are growing every day. This is exactly how an unfathomable net of mutual outstanding liabilities is formed (see, for example, Aslund, 1996 B, pp. 256-264).

It has been a long tradition of any command economy that whenever any enterprise would have accumulated (sometimes on purpose) a bunch of debts, its leadership would request the governmental agencies (Communist Party management organs, the Planning Committee, the Ministry of Finance, etc.) to write down them and, as a rule, such requests would easily be satisfied. Thus, to the extent that any debts could have been written down, the accumulation of debts, as such, had never been considered a “dangerous” practice. The “routine” of debt accumulation/down-writing is so deeply rooted in the command economic system that periodically it can “reveal” itself in the process of transformations as well, although it may be disguised by things like “tax amnesty”, which sometimes can be backed even by some new politicians pretending to be genuine reformers.

#### ***4. Homo Transformaticus and Post-Delets***

In fact, human factor plays a decisive role in any economic process. The “routine” which reproduces necroeconomy depends, *inter alia*, on the behavior of a human that undergoes the transformation from *homo soveticus* (one who is totally oppressed by and totally depends on the State), formed under the conditions of command economy, into *homo economicus* (one whose motivation is based either on getting maximum benefits (in one’s household), or maximum profits (in one’s company)), a type of human being that is characteristic to market economy.

To do justice, one has to note that according to a very remarkable belief, one of the characteristic features of the Russian economic school is the recognition of primacy of social approaches over individual’s behavior and motivation, as a result of which the Russian worldview rebuffs the idea of *homo economicus*. According to the same belief, Vladimir Lenin just reproduced in

his doctrine the traditions of the Russian economic thought (Abalkin, 2000, p. 15). If we agree with this, then we will have to recognize that *homo soveticus* is nothing but a product of the Russian idea of how world is organized.

We refer to that type of man – that is in the middle of post-Communist transformation – as *homo transformaticus*. This is a kind of human that is not yet entirely liberated from the fear of State and due to traditional way of life still depends on the State, but in his behavior one can detect the awakening of personal interests and motivation (Papava 1996, 1999 A, 1999 B).

In entrepreneurship *homo transformaticus* assumes a special shape whose roots can be found in command economy.

Even command economy could not succeed in rooting out market economy (more precisely individual elements of it) in its entirety. The latter was so much suppressed by the State that could survive only under the protection of “shadow” economy (Shokhin, 1989, pp. 57-83). As a matter of fact, no single director of command-economy-controlled enterprises (with rare exceptions) could avoid the breach of Communist rules in managing his enterprise, which breach sometimes consisted in applying the elements of market economy, and for that reason, their activities could only be assessed as “shadow” economic activities. Despite this, directors of command-economy-controlled enterprises failed to transform themselves into market-type entrepreneurs. In principle, success was totally impossible, as they had to confine themselves to the limits of command economy.

Perhaps it is for this reason that market-oriented behavior of enterprise directors was labeled as “deletsship” rather than entrepreneurship and they were known as “deltsi” rather than “entrepreneurs”. Russian word “delets” (pl. “deltsi”) stems from the word “delo”, which should be translated as “business”. To that extent, a word-by-word translation of “delets” must be “businessman”. However, such a translation would be incorrect, as English “businessman” denotes a person who is engaged in lawful activities, while Russian “delets” is a

derogatory word used in reference to anyone who makes illegal, illegitimate, and even shameful deals. As long as the phenomenon which is described by the word “delets” is essentially of Soviet origin, there is no reason to translate it into English.

After the collapse of command economy many deltsi managed to retain their positions. Furthermore, after the privatization of their enterprises they took advantage of the rights of employees and became the owners of those enterprises (Aslund, 1996 A). Some of them have hired managers, but all of them have tried (especially at the initial stage of post-privatization period) to apply their “delets-type mentality” in the course of company management.

Just like *homo transformaticus* is not yet *homo economicus*, former deltsi have not transformed into entrepreneurs yet. Thus, in the realm of entrepreneurship, *homo transformaticus* assumes a title of “*post-delets*” (Papava, Khaduri, 1997, pp. 28-29).

It is exactly post-deltsi who are at the back of public- or private-sector-based necroeconomy. It is exactly them who are the “initiators” of command-economy-type “routine” behavior.

Having taken advantage of their old contacts, post-deltsi succeeded in making a way into the governmental structures (parliaments, executive authorities) where they have been doing their best to politically justify and make longer the life of necroeconomy.

There is no doubt that necroeconomy is only in the interests of post-deltsi and until as a result of institutional reforms post-deltsi will be replaced with entrepreneurs, there is no reason to believe that necroeconomy will ever come to end.

## **5. The End of Post-Communist Transformation of Economy**

The negative impact of necroeconomy on the development of post-Communist nations is obvious. Consequently, what we need to do is to identify and utilize a mechanism which would enable us to cope with the problem of “dead” enterprises in an “automatic regime” characteristic to market economy. In other words, we have to take advantage of the said mechanism in order to have market economy be established.

The key to a successful solution to the problem consists in the above-mentioned evolutionary theory of economic change.

“Routine” which would be commensurate to market economy must be shaped primarily in the fifth group, namely a newly established private sector. The State has to focus exactly on that group and to assist it in overcoming the embryonic phase, expanding and developing. The State has to provide for creating stable political and microeconomic environments, which would facilitate the formation of new firms based on private investments. The post-Communist State, in defining its economic policy, must give priority to the overall development and expansion of the fifth group at the expense of the first and third groups.

Even secondhand-investment-based companies of the fifth group, irrespective of their poorer appearance, under the conditions of favorable legal framework, practically can not underpin necroeconomy, as the very style of establishment and operation of such companies is market-driven, for which reason the market “routine” of such companies, in case of the loss of competitive capacity of the company’s products, can ensure the company’s “withdrawal” from the market with the aid of market mechanisms.

As per the enterprises comprising the second and the fourth groups, no matter who is owner – the State or private companies that took over as a result of privatization – all of them need to attract new investments through

privatization or long-term concession of a certain portion of their assets to strategic investors. Otherwise, there is a strong likelihood that the vitaeconomic potential of these groups will be transformed into the necroeconomy of the first and the third groups.

As was noted above, merely privatization, as such, can not eradicate necroeconomy. For this reason, to revitalize the “dead” but strategically important enterprises of the first group, the government has to take the following step, which is the only solution to the problem: to hold, as soon as possible, open international tenders for the selection of strategic investors to whom these enterprises will be conceded on a long-term basis (perhaps it would be fairer to speak about the concession of a right to start strategically important production in a “dead” body). It is very likely, however, that such a step will not be acceptable to strategic investors. In that case, the government will have to privatize such enterprises at symbolic starting prices, because “dead” enterprise can not cost much.

Absolutely no hopes can one have in regard of the third group – the privatized necroeconomy. The only true label that could be attached to the necroeconomic assets, is “scrap metal”. One of the most effective ways to get rid of necroeconomy (in its literal meaning) is to sell scrap, including oversees – this would enable the owner of the scrap to accumulate foreign currency resources and use them for the creation of vitaeconomy.

“Routine” of command economy resists to the recognition of “dead” machinery as a scrap metal, creates barriers to the selling, especially exporting of scrap metal and, thereby, extends the “life” of necroeconomy.

Theoretically, the bankruptcy law must be an effective tool against necroeconomy. Although several years have elapsed since the Parliament of Georgia adopted the bankruptcy law, the one which had been developed on the basis of international experience and with the assistance of international experts, unfortunately, the law turned out to be a “stillborn child”, or a *necrolaw*: under

this law, in Georgia, no single – actually bankrupt – enterprise has been recognized legally bankrupted up to now. The reason is that the law failed to “fit” the institutional environment existing in the country.

The above law is completely commensurate to international standards; it was approved of by all international experts who had examined it; but, in fact, it is not a viable law. I would call it a “sleeping beauty” from fairy tales.

The Georgian bankruptcy law is a good evidence that throughout post-Communist nations new institutions, under the pressure of international financial organizations, are formed by analogy with and purposeful and direct reproduction of the western originals (Shavans, Manyan, 1999, p. 43). As a result, the institutes that fit well developed market economies, after their transplantation into the post-Communist economies in transition very often are ineffective and sometimes even harmful to local soils. One has to keep in mind in this regard that the IMF is often justly criticized for its accelerated, simplified approach to institutional reforms, for which reason the process of formation of market economy is slowed down (Stiglitz, 1999).

Market economy “routine” can only be underpinned through creating market-driven institutes, replacing post-deltsi with entrepreneurs and, ultimately, eradicating necroeconomy. The end of necroeconomy is the only true indicator of the end of post-Communist transformation.

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