



Economy of post-Communist capitalism under the financial crisis

Economy of
post-Communist
capitalism

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Abstract

Purpose – The purpose of this paper is to distinguish the economic foundations of post-Communist capitalism and to examine the key economic problems of this type of society in the context of the modern financial crisis.

Design/methodology/approach – This question is approached by studying the “necroeconomy” as a phenomenon of post-Communist capitalism and the international experience of the dead firms, so-called “zombie-firms”, which do exist and “successfully” function in the most developed of economies as well with Japan being the most obvious example. Unlike developed economies, which are exposed to the threat of the zombie-ing of the economy under the conditions of a financial crisis, this threat is even greater for the countries of post-Communist capitalism owing also to their exposure to necroeconomy.

Findings – It is found that the financial crisis creates the favourable conditions for the zombie-ing of a necroeconomy. If in Japan, for example, the zombie-economy never touched the processing industries, then one of the qualities of the necroeconomy is to concentrate exactly upon this sector of the economy. The zombie-ing of a necroeconomy inevitably amounts to the zombie-ing of this already-dead sector as well.

Originality/value – The value of the paper is to determine the carriers of the necroeconomic and zombie-economic routines – *Homo Transformaticus* and *Zombie Economicus*, respectively. The contemporary financial crisis creates the danger of the transformation of *Homo Transformaticus* into a *Zombie Economicus*.

Keywords Capitalism, Marxist economics, Market economy, World economy

Paper type Research paper

1. Introduction

Almost 20 years have passed since the beginning of the period of post-Communist transition to a market economy. Naturally, this has resulted in the accumulation of a rather rich experience overall and one which allows us make some generalisations. It may be asserted, that market economies, as such, have been established in almost all of the countries of the former Socialist bloc with the period of transition over and the individual newly independent states having passed through this period with varying degrees of success.

Some of the countries were so successful within their movement towards a market economy that they achieved European Union (EU) membership (Cameron, 2009; Papava, 2006) whereas others – in fact, all of the post-Soviet nations with the exception of the Baltic states – became “prisoners” of their own product; that is, post-Communist capitalism (Papava, 2005) which is a very special phenomenon of modern times and which includes in itself a wide range of different forms of capitalism (Crouch and Streeck, 1997; Gwynne *et al.*, 2003; Hall and Soskice, 2001).



The paper aims to distinguish the economic foundations of post-Communist capitalism and to examine the key economic problems of this type of society in the context of the modern financial crisis.

Although financial markets are not developed in the post-Communist countries, it was also expected that even these countries could not escape any negative implications of the global financial crisis (Åslund, 2009; Dabrowski, 2009).

The paper is organized as follows. Section 2 defines the essence of the economic foundations of post-Communist capitalism; Section 3 characterizes the phenomenon of a zombie-economy as a heritage of financial crises; Section 4 analyzes the similarities and differences between a necroeconomy and a zombie-economy; Section 5 explores the reproductive mechanisms of a necroeconomy and a zombie-economy; Section 6 identifies the carriers of the necro-economic and zombie-economic routines; Section 7 gives the answer on the question how to get rid of necroeconomies and zombie-economies and Section 8 shows the danger of mixing of a necroeconomy and a zombie-economy under the contemporary financial crisis. Finally, Section 9 concludes.

2. Where a necroeconomy is from?

The absence of competition in command economies quashed the only effective stimulus for economic development. As a result, the quality of products, as a rule, was very low – as were their prices – which were maintained artificially by means of national budgetary subsidies.

After the collapse of the Communist regimes and their command economies, the countries of the former Soviet Union found themselves with only a very small amount of goods to supply to the global market. With few exceptions, such as some hydro-energy outputs, oil and gas extraction and the primary processing of raw materials, the goods manufactured they manufactured failed to meet the high international standards as a result of their overall low quality and or high prices. In fact, no markets existed for these particular products. Moreover, in principle, there was no way that they could have existed in that an economy of this type is nothing more than a corpse or a so-called “necroeconomy” (Papava, 2002, 2005) or, similarly, a “virtual economy” (Gaddy and Ickes, 2002).

Naturally, even if one part of an economy is dead, the rest of it may still be alive which can be referred to as its “vital economy” or “vitaconomy”. By its substance, this is nothing more than market economy, and economics, as such, is something which deals with the economy as a vital system.

What does necroeconomy have in common with vitaconomy and how do they differ?

In a necroeconomy, like in a vitaconomy, some goods may be produced which in fact means that there may exist supply. In contrast to those goods produced in a vitaconomy, however, those emanating from a necroeconomy are in a situation of no demand owing to their low quality and or high prices.

If any segment of an economy is “dead”, then theoretically there should be no problems within. This explains the limited focus from the side of economic theory upon the problems of such a post-Communist market economy in which necrocompanies exist.

Specifically, in the countries which are still undergoing the process of post-Communist transformation – as well as those in which post-Communist capitalism has already been established – necroeconomy has grown on top of the roots of the command

economy's technical bases. The necroeconomy is exactly that which differentiates the economy of post-Communist capitalism from all other models of capitalism.

The majority of the necroeconomy in the public sector, as a rule, consists of large- and medium-size processing industry enterprises which, depending upon the types of goods they produce.

On the other hand, enterprises within the energy sector (first of all, electricity generation and transmission and the extraction and distribution of oil and gas), as well as those of transport and communications constitute a basis for the viteconomy in the public sector. When privatised, they move to the privatised viteconomy.

The privatised necroeconomy indicates, that only the change in ownership by itself does not automatically entail the restarting of formerly idle enterprises in that a "corpse's" status does not depend upon whether it is owned by the government or a private firm.

3. Zombie-economy, as a product of financial crises

We have already stated that necrocompanies are found within the countries of post-Communist capitalism but the question arises of whether or not this is a problem confined to such countries in transition alone or if these sorts of enterprises also exist in developed and or developing economies.

As international experience shows, dead firms do exist and "successfully" function in the most developed of economies as well with Japan being the most obvious example (Hoshi, 2006). These insolvent and, in fact, bankrupt firms which continue to operate despite their "mortality" are commonly referred to as "zombie-firms".

A system of continued lending is the key source of the sustainability of these zombie-firms (Caballero *et al.*, 2008; Smith, 2003) with their loans granted by so-called "zombie-banks" which extend beneficial credits to the firms (in particular, interest rates for such loans are lower than average rates at the market level) (Hoshi and Kashyap, 2005; Smith, 2003). In full risk of stating the obvious, these unreasonable loans can only lead these banks to direct and inevitable losses (Ahearne and Shinada, 2005, p. 368).

This, therefore, is the maintenance plan for zombie-firms but how, one may ask, do zombie-banks manage to survive under such circumstances? As a rule, such banks are backed by their country's governments (Kane, 2000b, p. 301) which grant them all kinds of guarantees and assure their deposits, amongst other things, which eventually means that zombie-banks exist at the expense of taxpayers (Kane, 2000a, p. 164). To a certain degree, such a financial system even encourages "healthy" firms to turn into Zombies (Hoshi, 2006, p. 40).

As a result of the aforementioned relationships between zombie-firms, zombie-banks and their governments, a "zombie-economy", then, develops which becomes a heavy burden for the "healthy" segments of the economy. In particular, zombie-firms, by mere their existence – and which enjoy guaranteed beneficial loans from zombie-banks – block the emergence of new "healthy" firms in the market (Hoshi, 2006, p. 33) as they have to borrow at rather higher interest rates (Caballero and Kashyap, 2002). In addition, because of their access to guaranteed beneficial loans, zombie-firms, in their fight for market shares, are at liberty to drop prices (Smith, 2003, p. 288) and raise the salaries of their employees (Hoshi, 2006, p. 33). The limited market access for "healthy" and, even more so, productive firms eventually leads to the reduced productivity of the whole economy (Ahearne and Shinada, 2005, p. 364).

A zombie-economy takes its roots in times of a financial crisis (Ahearne and Shinada, 2005; Hoshi and Kashyap, 2004). Under the conditions of stagnation, the economy becomes characterised by a stoppage of production and trade for a relatively long period of time which, in turn, gives rise to unemployment, a reduction in wages and salaries and the overall decline of the standard of living. During these times, governments, as a rule, are called to help the economy to overcome such difficult conditions through the provision of bailouts and other attempts at keeping the banking sector (to avoid a banking crisis) and the entire economy on the surface.

After the end of a financial crisis, the economy receives its own lifeless portion as a legacy of the difficulties and continues to try to preserve the old system of the government's financial aid which was readily available to it during the crisis. A zombie-economy, therefore, can be viewed as a legacy of a financial crisis.

It must be emphasised that a zombie-economy is a phenomenon peculiar not only to Japan and other developed market economies (Holle, 2005) but also to those countries with developing economies as international experience has shown (Kane, 2000a).

4. What is the common between a necroeconomy and a zombie-economy?

One might have the impression that the terms necroeconomy and zombie-economy refer to one and the same phenomenon; that is, a dead economy which continues to subsist despite its lethal status. In fact, such an impression is both superficial and misleading in that whilst the two "economies" do indeed share one commonality – there is no doubt that they are both dead – there is a wide spectrum of significant differences between them.

First of all, both economies developed in essentially different economic systems. A necroeconomy grew forth from a command economy whilst a zombie-economy is the offspring of a market economy. Further, a necroeconomy, in fact, has nothing to do with a financial crisis whereas a zombie-economy is the immediate end result thereof. It is important to note once again that the existence of zombie-firms depends in the main upon zombie-banks whereas necroeconomic agents subsist by means of immediate and direct subsidies from national budgets or tax exemptions. Moreover, the differences between a necroeconomy and a zombie-economy have also a lot to do with the sectors within which are mostly directly and readily exposed to their influences.

A necroeconomy, therefore, generally expands to large- and medium-size manufacturing industries as opposed to zombie-firms which show no traces of existence therein as evidenced by the situation in Japan's economy (Hoshi, 2006). Moreover, the large manufacturing enterprises in a post-Communist capitalist country, have the greater probability of becoming a part of a necroeconomy. On the other hand, as the same Japanese experience demonstrates, most large-size firms, due to their great financial powers, are not zombie-firms but may also often be encountered in those so-called small businesses which are relatively "larger" than others (Hoshi, 2006).

It is important to note that whilst all international financial institutions, such as the International Monetary Fund and the World Bank, insist that the post-Communist capitalist governments eliminate all kinds of national budget subsidies and tax exemptions, all lobbying efforts are mobilised towards pushing those bailout programmes into providing some extensive financial support to the national governments in order to enable them to build up some favourable lending systems under the circumstances of the financial crisis (Kane, 2000a, p. 163; b, p. 288).

One may arrive at the conclusion, therefore, that necroeconomies and zombie-economies are related to each other but still differ to a great degree from each other as individual economic phenomena. Unfortunately, however, these differences are not always given due consideration. In some studies, the peculiarities of a necroeconomy are overlooked which means, as a result, that the problems of dead firms in the post-Communist countries (mostly China and Russia) are examined within the context of zombie-economies (Kane, 2000b, pp. 300-1; Lindsey, 2002, pp. 126, 153; Shleifer and Treisman, 2000, pp. 106-7) rather than necroeconomies.

5. On the reproduction of a necroeconomy and a zombie-economy

A key question with respect to a necroeconomy and a zombie-economy is what ensures their stable existence.

The answer may be found in an evolutionary theory of economic changes (Nelson and Winter, 1982) wherein the key tool is the concept of “routine” which implies a certain set of rules and ways of a firm’s conduct which regulates the reproduction (of such a conduct) (Murrell, 1992).

It is this very routine, which has developed over a period of several decades upon the roots of a command economy, which pushes dead companies in the countries of post-Communist capitalism to work in the no-longer-existing regime of a command economy. Without any special governmental support, therefore, the warehouses of these companies become filled with uncompetitive goods for which there is neither demand nor market. Given the fact that as a matter of principle these goods cannot be sold to anyone, the companies find themselves further and further in arrears as regards wages, salaries and debts to national budgets, social funds, energy sector industries and other businesses which eventually creates a network of mutually indebted businesses (Åslund, 2007a, pp. 132-3).

It was a long-established tradition in command economies that when an enterprise accumulated (often very deliberately) huge debts, its director raised the question before his country’s superior governmental institutions (such as Communist Party governing bodies, the Gosplan, the Ministry of Finance, etc.) to write off those debts and, as a rule, such requests were usually granted. Such a mechanism of off-writing of debts represented a firmly established routine which, however, unfortunate it may have been, reappears over and over in the countries of post-Communist capitalism and within various forms such as “tax amnesties” (Nikolaev, 2002; Shul’ga, 2002).

As for the routine of a zombie-economy, it develops under the conditions of financial crises wherein governments and banks collaborate with each other towards a common purpose of developing and implementing bailout programmes for insolvent firms and, thereby, avoiding a greater economic decline and a further growth of unemployment. In the case of a relatively long period of stagnation, such collaboration grows into an established order which establishes the rules of a firm’s conduct and, in turn, ensures the reproduction of such a conduct. In other words, the activities grow into a routine.

When a financial crisis comes to an end, the routine undertakes the mission to ensure the subsistence of a zombie-economy. The reason is that under all other equal conditions, and irrespective of the crisis, no government would tolerate the growth of unemployment which comes as an inevitable result of the closing down of zombie-firms. Undoubtedly, “healthy” firms are never able to instantaneously react to the disappearance

6. Who are carriers of the necroeconomic and zombie-economic routines?

The human factor, as a rule, is a matter of decisive importance for practically all kinds of economic developments.

The routine which reproduces a necroeconomy is conditioned by the behaviour of such a human being who is in the middle of the transition from the state of a *homo soveticus* (Buzgalin, 1994, pp. 250-3) – that is, one who is suppressed by the state and who totally depends upon the state – to *homo economicus* or a human being whose driving force is to get the maximum utility at a household and a maximum profit at a firm which is typical of a market economy.

The type of human being who manages the process of post-Communist transformation or, in other words, one who is a “central character” in post-Communist capitalism is someone I call *homo transformaticus*; that is, a human being who failed to completely release himself from both the fear of the state and the habit of living at the government’s expense even though he gradually gets used to the situation owing to his private interest in obtaining a maximum utility and profit (Papava, 1996).

In business, *homo transformaticus* assumes a special form whose roots may be traced back to a command economy.

Even in the times of a command economy’s reign, a market economy (or, much rather, certain elements of it) was not eradicated in its entirety. Simply, it was oppressed by the state to the degree that it could only subsist within a “shadow” sector (Shokhin, 1989, pp. 57-83). Under the conditions of a command economy, no director (perhaps with few exceptions) could possibly manage his enterprise without breaking a law adopted by the existing regime. Nevertheless, under the conditions of a command economy and given their suppression by the former Communist regime, such directors never became – and could not have possibly become – truly market-type entrepreneurs.

Even after the collapse of a command economy, most of former command economy directors managed to preserve themselves as directors in public sector enterprises within various capacities (Åslund, 2007b, pp. 137-40).

It is exactly former command economy director as a *homo transformaticus* who make up the spine of a necroeconomy in both the public and private sectors as they are the carriers of the routine of a command economy. By using their old connections, the former command economy directors manage to break into governmental organs (parliaments, executive offices, etc.) and use their influence to try to politically justify and prolong the existence of the necroeconomy.

During a financial crisis, a type of economic policy develops which proposes the government’s interference in the economy with its uppermost goal of rescuing it from a critical state, on the one hand, and encourages the addressing of the private interests of those economic agents who have found themselves on the verge of bankruptcy as a result of the said crisis, on the other hand.

As previously mentioned, a zombie-economy’s routine is the product of a market economy in the state of crisis. Consequently, it is not a simple *homo economicus* who is the carrier of this routine but, rather said, a mutation which was formed in the process of his adaptation to the deformed conditions of the market economy as a result of

the financial crisis. Conventionally, a *homo economicus* mutant may be called *zombie economicus* (Papava, 2009) in that he is the carrier of a zombie-economy's routine.

From *zombie economicus*, as an already accomplished phenomenon, *homo transformaticus* differs by the fact that he is still in the process of adaptation to a market economy and, as such, he has not yet been established as a type of human being. Since *homo transformaticus* is still developing, one may ask the question of whether or not it is possible for a *homo transformaticus* to grow into a *zombie economicus* under modern conditions of the global financial crisis.

7. How to get rid of necroeconomies and zombie-economies?

Theoretically, it must be made clear that the effective elimination of a necroeconomy is unthinkable without an effective bankruptcy law. As the experience of many post-Communist countries has shown, most of the past attempts at formally adopting bankruptcy laws have unfortunately produced only "stillborn babies" (Sánchez-Andrés and March-Poquet, 2002). In other words, they are "necro-laws" because the occurrence of factually bankrupt enterprises being proclaimed as legally bankrupt is something which happens only very seldom, if at all. In these countries, bankruptcy procedures are blocked by all possible means which, *inter alia*, may be explained by the assumption that bankruptcy does not "fit" into the institutional environments of those countries.

The elimination of a necroeconomy may only be accomplished by establishing such institutions which will boost the process of democratic reform and raise the efficiency of post-Communist transformation (Hare and Davis, 2006). The dying out of the phenomenon of a necroeconomy may be considered as an economic indicator of a country's successful overcoming of the stage of post-Communist capitalism.

An effective bankruptcy law is an effective tool in the fight against zombie-firms and zombie-banks. Unfortunately, however, one has to admit that the situation in developed and developing countries is not any better than it is in the countries of post-Communist capitalism (Claessens *et al.*, 2001). Specifically, there is a clearly observed tendency that the legitimate bankruptcy of many firms is not readily documented by means of appropriate legal procedures (Cussen, 2009).

8. The danger of the transformation of *homo transformaticus* into a *zombie economicus*

It is precisely within the context of the current crisis that the subject of the attack of zombie-firms upon the global economy has become so topical (Stepek, 2008; Willie CB, 2009) which resulted in the emergence of multiple research works within the so-called new economic field of "zombie-nomics" (LeLaulu, 2009).

It is an established fact that many developed countries have resorted to certain special governmental bailout programmes in support of their financial institutions and real estate businesses (Mau, 2009, pp. 22-3) which creates a threat for the development of a new zombie-economic routine. This threat may become quite real if the financial crisis continues long enough to enable the zombie-economic routine to take solid root.

If only a few short years ago, the existence of a zombie-economy in the USA was categorically negated (Bonner and Wiggin, 2003, p. 120)[1], most recently, however, many have started talking about the threat of the emergence of zombie-firms as a direct result of the financial crisis (Coy, 2009; Krugman, 2009b; Rajiva, 2009; Wong, 2008). As a consequence, the US Government's bailout plan has been referred to as

a zombie-programme whereas the US Treasury Department has been disparagingly called the “mother” of a zombie-economy (Kunstler, 2008).

To do justice, however, one has to underline that the first symptoms of the movement towards the zombie-ing of the US banking sector appeared long before the emergence of the present financial crisis when the US Government extended subsidies to American banks in order to stimulate their mortgage lending insurance plans for the benefit of low-profit segments of population which failed to meet general banking standards (Holmes, 1999).

Remarkably, experts assert that an interesting difference exists between the mechanisms of the emergence of zombie-firms in Japan and those in the USA. In Japan, for example, the government supports zombie firms through zombie-banks whereas the bailout plans envisaged in the USA are intended to be implemented without the mediation of banks even though the results in both countries are expected to be the same (Hoshi, 2009). Obviously, such an approach does not correspond to the reality which is being shaped in the USA in relation to its government’s domestic zombie-banks’ bailout programme (Willie CB, 2008).

Furthermore, the danger of the development of a zombie-economy in Canada (Poschmann, 2009) and some EU countries (Kelly, 2008; Schnittger, 2009) has become a real as well.

In the countries of post-Communist capitalism, the present financial crisis also encourages the development of such governmental programmes which are aimed at the government’s providing its financial support to perishing banks and firms (Illarionov, 2008c).

The current modern financial crises bring the principle of “privatisation of profits and nationalisation of losses” up to date (Mau, 2009, p. 10).

Unlike developed economies, which are exposed to the threat of the zombie-ing of the economy under the conditions of a financial crisis, this threat is even greater for the countries of post-Communist capitalism owing also to their exposure to necroeconomy. There were no doubts, for example, that many Russian companies, amongst those in other economies, were able to get rid of their debts under the financial crisis without the receipt of governmental support (Mau, 2009, p. 5).

If one bears the nature of the technical base, a necroeconomy in mind alongside the fact that it resides primarily in the industrial sector, then there is no surprise that it is exactly the drastic shrinking of industrial output under the conditions of the economic crisis through which a necroeconomy states its existence (Illarionov, 2008a, b).

In the absence of a financial crisis, post-Communist countries with a large-scale market feel the pain of a necroeconomy far less than those with relatively smaller ones given that there is an opportunity to compete with each other within the market’s large dimensions and governmental support (Schaffer and Kuznetsov, 2008) which creates the illusion that a necroeconomy does not exist. In smaller countries, however, this problem is rather severe due to the fact that many enterprises may have no domestic competitors at all (Papava and Tokmazishvili, 2007).

This difference between the large and small markets has an influence upon the governmental policies supporting a necroeconomy. In particular, the illusion of the absence of a necroeconomy caused by domestic competition blocks, to a great degree, a governments’ will to get rid of a necroeconomy. In countries with small-scale markets, however, the absence of analogous enterprises eliminates the conditions for domestic

competition which enables the governments of those countries to retain a greater stimulus to fight necroeconomy even though such a stimulus is not always utilised within a proper way (Papava and Tokmazishvili, 2007).

Under the conditions of a financial crisis, the governments of post-Communist capitalist countries may retain far less illusions that a necroeconomy exists. It comes as no surprise, therefore, that they witness a catastrophic decrease in their industrial output.

In view of the fact that it is precisely the financial crisis which creates the favourable conditions for the establishment of zombie-economy routines – that is, the zombie-ing of an economy – the zombie-ing of a necroeconomy is what happens in the countries of post-Communist capitalism which, in fact, is even worse than the simple economic zombie-ing which takes place in developed economies. If in Japan, for example, the zombie-economy never touched the processing industries, as we have seen, then one of the qualities of the necroeconomy is to concentrate exactly upon this sector of the economy. Consequently, the zombie-ing of a necroeconomy inevitably amounts to the zombie-ing of this already dead sector as well.

It is important to note that in Russia, for example, the first symptoms of necroeconomic zombie-ing emerged in the immediate aftermath of the August 1998 crisis in the country (Lindsey, 2002, p. 210) which gave rise to the phenomenon of the post-Communist zombie-economy (Lindsey, 2002, p. 211). The present financial crisis which has developed in Russia and which, in addition, has been “strengthened” by that at the global level, may continue to exist and, therefore, is able to have far more serious negative effects for Russia than its predecessor had. There is a very real possibility that *homo transformaticus* will eventually grow into *zombie economicus*, rather than into *homo economicus*, which means that the economic future of the post-Communist capitalist countries could be even more dubious than it is today.

9. Conclusion

The dead enterprises which the countries of post-Communist capitalism received as their legacy of the command economy have proven to be quite “tenacious of life”. *Homo transformaticus* is the carrier of a necroeconomy’s routine.

The occurrence of financial crises has encouraged the emergence of a kind of routine which guarantees the stability of a government’s bailout programmes implemented thorough the banking sector in support of *de facto* bankrupt firms. As a result, a network of zombie-banks and zombie-firms develops upon which the entire system of a zombie-economy rests.

Unlike a necroeconomy, whose routine is carried by a human being which is “still-to-be-formed”, a zombie-economy’s routine is carried by the “gone and departed” man, the so-called *zombie economicus*.

Under the conditions of the present financial crisis, the threat of a Zombie-economy is also aggressively knocking on the doors of those developed economies which, until recently, seemed to have escaped the zombie-ing of their economies.

This threat of an economy’s zombie-ing is even greater in the countries of post-Communist capitalism given that this zombie-ing also has a great deal to do with a necroeconomy which is a factor that will make it rather difficult to improve an economy’s health after the end of the financial crisis.

The only effective mechanism to get rid of both a necroeconomy and a zombie-economy is to adopt a sound bankruptcy law which, in turn, requires the strong political will of the ruling elite.

Note

1. Higher officials ignoring the problem of the existence of zombie institutions in the US financial system which is typical at the present time (Krugman, 2009a).

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