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## State-Owned Enterprises

### Types of Enterprises in the Post-Communist Economies

In the market economies, entrepreneurs and enterprises are traditionally believed to be the most important agents of the economy—creators of wealth, sources of innovation and progress. This view of an enterprise was challenged by Karl Marx. The Marxists believed exclusively in macro-economic rationality attributed to the society as a whole, and represented by a central planning board responsible for securing maximization of that kind of rationality. Marx himself often used a metaphor of the national economy as “one big factory” (Marx 1951:677). Within this framework, only macro-economic rationality counted.

The very notion of macro-economic rationality is also specifically understood: as the maximum possible satisfaction of the needs of society. Such formulations, found in all standard communist textbooks of political economy, require further refinements. The central planning board is given supreme authority to decide the needs of society (interpreted as an itemized and fully detailed list of products and services), and how priorities should be ranked (or which, and whose, needs should be satisfied first).

In a system designed according to a Marxist dogma, classical economic calculation problems (what to produce, how, and for whom?) were not solved on the enterprise level, but decided by a central planning board for the national economy as a whole. In other words, enterprises were not considered economic agents making economic choices—but merely “production units” or “the factories” (as they were often called in the communist countries), where the only problems to solve had a strictly technical and socio-political character. What really counted was the economic system as a whole.

Such a holistic view of an economy has serious practical consequences directly related to the way enterprises are perceived and operated. To illustrate that point, a few characteristic definitions of a “socialist enterprise” may be quoted:

By enterprise it is meant not financial value important for the capitalist owners, but living organism: a group of working people. (Sarabianov 1924:4)

By enterprise we mean a group of people united by common material interest, founded on the basis of a system of material production means, constituting a technical and economic entity, created to satisfy a type of needs of society. (Chelinski 1964: 48–49)

The Soviet Encyclopedia, published under Stalin, defined enterprise as “a set of tools and production means, inventories and other material funds used by people to produce or to perform any kind of work. Special nature of an enterprise is determined by type of a social system” (*Bolshaya Sovietskaya Encyklopedia* 1952, vol. 34:408).

Among the most important features of “socialist enterprises,” the following seem to deserve special attention:

1. *Maximization of economic surplus, or even the production of goods and services, were not considered the only and the most important functions.* Serving political priorities directly (for example, by providing components for heavy or armament industries, or by supplying revolutionary movements or “brother countries” abroad) were considered much more important, to the extent that cost effectiveness did not count at all.
2. *Socialist enterprises were supposed to provide for the needs of their employees, such as medical care, housing, vacation, recreation, and—first of all—political indoctrination.* These activities were often favored and over-developed at the expense of not only economic efficiency, but also production itself. They remain an important part of the activities of the big state-owned enterprises, even in countries considered to be the most advanced on the road to a market economy. Their elimination carries a risk of compromising the social equilibrium of these enterprises, especially during the economically difficult period of transition. In 1991, for example, East German workers strongly opposed elimination of social welfare activities of their enterprises.
3. *Enterprise was supposed to execute the plan targets decided at the level of the central planning board.* Such plan targets had to serve the needs and the interests of the national economy, not “particularistic” interests of the enterprise itself. Consequently the management of the enterprise could not know the full extent of, and could not evaluate, planning decisions taken above it. Its role was to obey, to execute, and to “mobilize” the workers and personnel of the enterprise to meet, and if possible to exceed, the plan targets. As N. Grossman put it, as early as in 1924, “enterprises did not know the markets and the markets did not know them” (Grossman 1924). This statement remains valid. In-

terviews conducted by the author with managers in Poland, Hungary, and Czechoslovakia in 1990 and 1991 clearly indicate that marketing knowledge is one of the weakest points of their skills, and that a “sellers market” mentality is still alive. In emerging market economy conditions, such a mind-set considerably inhibits performance of the enterprises.

4. *Initiatives of the enterprise management and the workers should be directed toward input rationalization.* This meant producing more with the same amount of input, or minimizing the input necessary to produce a given amount of output. Such an understanding of rationalization of the functioning of the enterprise is rightly considered to be one cause of the poor quality of products produced by socialist and post-socialist enterprises.
5. *Enterprises were also considered to be “accounting units,” where production costs and input structures were calculated.* It is significant, however, that the enterprises themselves were not supposed to be the users of the accounting systems—because economic calculation and resource allocation decisions were done above them, on the central planning board level. That is why the enterprise accounting systems built in the communist economies were always aimed at the government agencies supervising the enterprises. This strange accounting logic has not yet been overcome, and remains one of the major obstacles to effective cooperation between western and socialist or post-socialist enterprises. Passing to international accounting standards and training of people accordingly, seems to be a major problem and long and difficult process because it involves complete turn-around of the accountants’ and managers’ mind set: switching from “bookkeeping” to accounting in the modern meaning of the word. This process is far from being completed even in the most advanced countries such as Hungary or Poland.

Two aspects of the enterprise concept were ever present in communist theory and practice:

- Technical or “technocratic”—an understanding of an enterprise primarily as a system of material production factors, such as machinery, equipment, buildings and technology (clearly visible in the definition taken from the Stalinist encyclopedia)
- Social—an understanding of an enterprise primarily as a group of people jointly contributing to the realization of the plan targets (reflected in other, more recent definitions)

At different stages of development of the communist economies, different degrees of importance were attributed to these two aspects of the notion of the enterprise. During the Stalinist period the technical aspect was given absolute priority, while communist reformers active since the late 1950s stressed the social side of a socialist enterprise. Development of industrial sociology in the USSR and other communist countries in the '60s and '70s is due to this shift in understanding of the nature of the enterprise. It is obvious, however, that under the communist system, the enterprise was never understood to be an independent economic agent acting in a market environment.

Analysis of post-communist enterprises, from the perspective of a highly developed market environment, seems quite difficult. It requires precise discrimination between the different types of enterprises coexisting, at the present time, in the post-communist economies:

- Big state-owned enterprises (mainly in heavy and machine industries) that still maintain an upward orientation toward government, and act as much as possible according to the old "rules of the game"—the "dinosaurs"
- More market-oriented state-owned enterprises, with a relatively high proportion of exports, that try to act in a business-like manner—the "pretenders"
- Joint ventures with foreign capital participation—the "mixed marriages"
- Small privately owned companies—the "mom-and-pop shops"
- Large privately owned companies—the "growing sharks"

Dinosaurs emerged as a consequence of Stalinist industrialization dogma, which focused on heavy industries and those related to the military complex. Stalinist dogma stipulated the enormous size of production facilities, as well as their social and political functions (e.g., cultural, recreational and social welfare activities). Such industrialization programs were often carried out a long time after Stalin's death—in the 1960s, '70s, and even in the '80s.

Pretenders have been formed mainly under the influence of decentralization and the parametric reforms undertaken by communist reformers in the '60s and the '70s.

Most of the existing mixed marriages were born out of the "eleventh-hour" communist reforms directly preceding the fall and total disintegra-

tion of communism, and the first period of early marketization of the post-communist economies.

Mom-and-pop shops were always present in some of the socialist countries (e.g., Poland, Hungary, and East Germany)—but even there, these shops were subjected to a number of drastic restrictions by the communist rulers, and remained marginal until the end of communism. In order to survive in a hostile, bureaucratic, and corrupt environment, small private entrepreneurs had to develop a considerable part of their activities in the “shadow economy.” The experience of the post-communist countries shows very clearly that the mere existence of a legal private sector under communism, in some of them, played a considerable positive role in laying the ground-work for a market economy.

Growing sharks are clearly carrying the message of completely new times. It is also obvious that the economic system, which must simultaneously accommodate such different economic entities, has to be incoherent and unstable. Dinosaurs are still responsible for the lions share of employment and industrial GNP in the post communist countries. They are the main source of the economic problems, along with the undeniable difficulties experienced by most pretenders when they try to adjust to global market conditions.

Recent examples and cases will be presented in order to demonstrate how enterprises of different categories actually respond to unique conditions created by the transition from centrally planned to market economies.

### *Dinosaurs*

Most of the “dinosaurs” resulted from the “socialist industrialization” drive initiated in the USSR by Stalin under the first five-year plan, in 1928, and followed obediently by other socialist countries (with exception of Hungary) practically until the end of communism. Such ambitious industrialization programs created large populations of enterprises for whom the label “dinosaurs” is justified for two reasons:

- They were over-sized and extremely vertically integrated, nearly to the point of self-sufficiency.
- They were inefficient and employed polluting, often dangerous technologies.

From the perspective of the structures of the post-communist economies, the Stalinist industrialization drive left behind a large proportion of

low-value-added smokestack industries unable to turn out world-class products at reasonable cost.

Post-communist dinosaurs are exemplified by two cases: a Polish coal mine, "Rainbow," and a Soviet truck engine factory.

*Rainbow.* Coal mine Rainbow<sup>1</sup> is situated in the mining region of Silesia, near the major industrial town of Katowice. Built in the 1960s, it still sits on relatively abundant coal reserves. Rainbow employs around 7,000 people, including more than 5,000 miners who work in difficult conditions nearly 3,000 meters under the surface. By comparison, British coal mines of comparable capacity employ about one-tenth the manpower under the surface—and yet have close to five times higher daily production. The British advantage is due mainly to modern efficient equipment, more efficient work organization, and a much lower percentage of administrative personnel dictated, until recently, by the requirements of the communist economic bureaucracy.

In order to understand present situation of Rainbow, one has to bear in mind the specific circumstances of the coal mining industry in communist Poland after World War II. Until 1990, coal mining had escaped all reform attempts, and had kept a management system close to the "classical Stalinist" model. This was due to two factors.

First of all, close to 80 percent of the country's energy needs are met by coal and lignite—along with a large chunk of the country's hard currency earnings. This resource is especially vital, since Polish industry is two-to-five times more energy intensive than Western European industry (Karpinski 1986). The management system sheltered the industry from international competition, through a highly developed system of direct and indirect subsidies, and gave considerable pay and benefit privileges to the miners. Such a system was especially beneficial to the communist *nomenklatura* in the industry—but the miners also benefited from it.

Second, coal miners were consistently perceived as a political power base by all governments, including those led by Solidarity. The party leader of the 1970s, Edward Gierek, rose to power from the Silesia mining region. He clearly gave high priority to primitively understood (Stalinist-style) further industrial development of the region—which resulted in catastrophic degradation of the environment, depletion of natural and human resources, and devastation of the infrastructure. In spite of being perceived as a "workers' aristocracy" in communist Poland, miners took an active part in the Solidarity movement of 1980–81, and actively opposed the imposition of the martial law. (Seven miners were killed when police stormed one of the mines in December 1981).

After the imposition of martial law, however, communist authorities had to turn to the miners again for more coal and new privileges, and pay increases naturally followed. Nevertheless, the mining region of Silesia remained one of the strongholds of Solidarity—and in 1988 and 1989, miners again played a crucial role in the final overthrow of the communist regime. This gives them considerable political leverage with the new post-communist governments. It must be noted that miners in the Ukraine and Siberia, in Russia, played a very similar political role in 1990 and 1991.

The “shock treatment” therapy implemented by Vice Prime Minister Balcerowicz, in 1990, necessitated an end to the exceptional situation of coal mining. Subsidies were gradually eliminated and the costs of supply dramatically increased, which dangerously narrowed the margin of competitive advantage enjoyed by Rainbow’s coal on the international market. At the same time, deep recession limited domestic demand in a way that was completely new to the Polish coal mining industry.

The shock of the new economic situation was combined with very profound organizational changes within the industry. The highly centralized monopolistic structures controlling the whole industry were dissolved—and replaced by a population of individual coal mines acting as separate state-owned enterprises. The reforms had two objectives.

First, they were supposed to lead to a massive exchange of managers and the dismantling of the “old boy networks” of the formerly communist *nomenklatura*.

Second, the reforms were meant to facilitate a restructuring of the industry by closing inefficient, exploited mines—and enabling the remaining mines to compete in domestic and international markets. While this would require considerable capital investment in modern equipment, the new equipment should make possible a more efficient work organization and a higher degree of processing of the output. The industry would produce the “cleaner,” more energy-efficient and standardized product required both by foreign and domestic users, and would secure higher prices and advantageous contracts (i.e., large, steady orders).

Local chapters of the Solidarity trade union, as well as Solidarity-controlled workers self-management organs (the “workers councils”), were very active in promoting these changes. At the same time, however, union officials were under strong pressure from rank-and-file members to protect jobs and the real value of wages.

In the context of Eastern Europe, protection of jobs has a specific meaning and significance because of very low, or practically nonexistent, labor mobility—the result of both the housing shortage and the long tradition of lifetime employment of the miners in the same mine. The need to protect the workers’ interests, as felt by trade union leaders in the coal



mining industry, is made even more urgent by the rivalry between Solidarity and the communist trade unions, OPZZ.

Communist trade unions were created by the party in 1982 after the declaration of the martial law and the banning of Solidarity. They were, and still are, perceived by many as “traitors.” But in order to keep and attract membership, they have become aggressively militant. At the same time, Solidarity has neglected typically trade union activities and has become, to a much greater extent, a political organization. Moreover, since all the non-communist governments emerged from Solidarity, it began to be perceived as an official government trade union. As such, Solidarity bore part of the responsibility for the hardships—unemployment and the reduced purchasing power of the working class—resulting from the “shock treatment” measures applied by these governments. As result, the communist trade unions have kept, and often increased, their membership and influence at the enterprise level.

Industrial problems, as presented above, are very closely related to regional policy issues. Silesia is traditionally a heavy industry region similar to the Rhur valley in Germany, Alsace-Lorraine in France, or the Appalachian region in the U.S. It has built its relative economic prosperity on coal mining, steel making, and bulk chemicals. It’s environmental situation is, at present, close to a catastrophe. It’s economic and industrial base is shrinking dramatically as a result of the transition to a market system (especially through the “shock treatment” of eliminating subsidized pricing) and the opening of the economy to international competition. The whole region—until recently, the most economically advanced—is threatened by massive unemployment.

The political significance of these regional issues can be understood when one takes into consideration crucial the political role of the region in national politics. Furthermore, the region’s massive concentration of blue-collar workers is torn between Solidarity and the communist, or post-communist, political formations—such as OPZZ or the social democratic party, which emerged from the communist party in 1990.

All the problems mentioned above were clearly visible at the Rainbow coal mine. Paradoxically, they were even more pressing because of the relatively recent construction date of the mine. Capital investment was not yet paid off, which considerably increased “dividend”—a fixed assests-value tax imposed by the government on state-owned enterprises. The Polish-made equipment used by Rainbow was not technologically advanced enough to provide the labor-efficient organization and technology of extraction that would enable coal mines operating in geological conditions similar to Rainbow’s, to remain competitive on world markets in the ’90s.



The comparison with British coal mining is especially relevant. Using traditional equipment and work organization, Rainbow had to conduct extraction on 18 levels in order to reach its full capacity of 18,000 tons of coal per day. This required very high employment levels and a very complex production management system, which further increased the cost of extraction. To make a bad situation worse, the technology and equipment used at Rainbow did not guarantee the quality of output required by more discriminating buyers, and which would have justified higher asking prices.

Due to its relatively high production costs and outdated (but still not paid off) equipment, Rainbow was experiencing serious problems that were reflected in a highly variable production volume well below its full capacity. Rainbow also paid lower wages than older neighboring mines. This situation became intolerable for both the trade unions and the workers' self management council. Under the enterprise law of 1981, workers' councils at state-owned enterprises have a say in selecting and dismissing CEOs. At Rainbow, all of these workers' organizations jointly initiated the return, and nomination as CEO, of Miroslaw Maron.

Mr. Maron had been a chief engineer, or technical director, at Rainbow in 1982. He was known in professional circles of the industry for his technical knowledge and competence, and also held a Ph.D. in engineering. Maron was well acquainted with the most advanced mining technology used in Western Europe and the U.S. When martial law was imposed in 1982, Maron was still a communist party member—and remained in the ranks until the party dissolved itself in 1990. Nevertheless, he had been dismissed for political reasons: he had openly expressed support for Solidarity. In spite of these political issues, even the communist authorities could not afford to waste Maron's technical knowledge and expertise. Shortly after his dismissal from Rainbow, Maron was appointed chief engineer at one of the worst (i.e., the most run down) mines of the region. His assignment was to "save" the mine, and to ensure a steady production flow. When he succeeded in this nearly hopeless situation, another similar appointment followed—and the "rescue mission" was again successful. Maron became quite famous in Silesia, and it was this reputation that brought him back to Rainbow.

Immediately after his nomination, Maron came up with an attractive restructuring plan. He proposed to buy immediately one—and later, three or four—of the latest-generation foreign-made coal mining combines, which would make possible the automated extraction of high-quality coal. At first glance, the whole project looked financially unrealistic because of the high cost of the equipment: the estimated cost of one machine was about \$25 million. Maron's business plan took that into consideration: it

called for the purchase of only one machine initially to be paid off through exports of the additional coal produced. A British manufacturer of coal mining combines, Anderson-Longwall, was interested in supplying one of its latest-generation machines, and also secured the participation of Royal Dutch Shell in the sale of coal from Rainbow on the international markets—which provided for advance financing of the purchase.

Anderson-Longwall wanted to start a joint venture with two Polish manufacturers of coal mining equipment, Famur and Glinik, to produce the next machines jointly. The new enterprise would supply the machines on continuous basis to other Polish, Eastern and Central European markets, and would also offer them to the former USSR republics and China (which traditionally bought its coal mining equipment from Poland). Such a complex agreement, involving two major multinational corporations, was negotiated by Maron as early as November 1989. Complete autonomy of the Rainbow coal mine as an independent enterprise was clearly a precondition for success of the whole venture. Such autonomy had not yet been granted at the time Maron's business plan was originally presented. Coal mines were still under the umbrella of the State Coal Agency and Ministry of Industry. All imports of mining equipment and machinery were handled by the state-owned foreign trade company, Kopex. All exports of Polish coal traditionally went through another state-owned monopoly, the foreign trade company Weglokoks.

All of these powerful agencies were vitally interested in maintaining their influence over the whole coal mining industry and each one of the mines. Maron's plan clearly went against their interests. The state agencies were able to counterattack and to harm Rainbow and its managing director in many different ways—even without openly using their administrative powers. Instead, they relied on the quasi-monopolist position they still maintained. Such repressive actions might include blocking or slowing sales of coal from Rainbow, or making it more difficult and expensive for Rainbow to purchase other equipment.

Maron was too experienced to take such a risk, so he worked out a compromise: both Weglokoks and Kopex became partners in the proposed deal. Weglokoks was given its share as intermediary, for selling Rainbow's coal to Shell. Kopex received a similar share of the transaction to import equipment from Anderson-Longwall to Rainbow, and eventually to other Polish coal mines. Commissions promised to the foreign trade companies made the whole project more expensive for Rainbow—but Maron considered it to be a fair price for a compromise enabling him to get the OK from the State Coal Agency and Ministry of Industry. The letter of intent was finally signed by all parties in July 1990. The contract with

Anderson-Longwall was scheduled to be signed in August 1990, and installation of the first machine was expected in early 1991.

The whole restructuring program had to be approved, however, by the workers' council of Rainbow—and in the summer of 1990, such approval was very unlikely. A personality clash and rivalry between Maron and Mr. Karcz, who was president of the workers' council, greatly contributed to this situation. Karcz was an engineer who had worked at Rainbow for many years, recently as a foreman. It should be noted that most workers' councils are headed by middle managers or engineers—who often use that kind of activity as an opportunity for quick advancement, and to climb to managerial positions that are often still occupied by the old communist *nomenklatura*. This was clearly the case with Karcz, who wanted to take Maron's place.

In order to achieve his goal, Karcz initiated a thorough examination of the restructuring program by the workers' council. He did not criticize its technical validity, but raised doubts about its financial feasibility—and pointed out that restructuring would lead to considerable layoffs.

At the beginning of 1990, a session of the workers' delegates (a large body composed of several hundred democratically elected delegates, who elect the workers' council) supported Maron's program, and by the same token forced 12 members of the workers' council to resign. This meant that a new election of the workers' council had to be called. The election produced unexpected results: Karcz skillfully played on the fear of layoffs, and raised suspicions of financial manipulations involving Maron and the consulting firm preparing the financial feasibility study. Thus, Karcz reinforced his position and gained an absolute majority within the workers' council. This enabled him to block approval of Maron's restructuring plan until November 1990, under the pretext of a thorough examination by the workers' council.

Meanwhile the idea of a new open competition for the director's position, launched by the workers' council, slowly gained acceptance among the workers' representatives and trade union leaders. In November 1990, it had become clear that Karcz was going to run for director—and that with the support of the workers' council, he had every chance of winning. With his restructuring plan blocked and his position challenged, Maron handed in his resignation, effective immediately, and left for an overdue vacation.

Mr. Karcz's triumph was short-lived, however. Immediately after Maron's resignation, the bank froze Rainbow's account and stopped financing its operations. Dropping sales and the lack of a viable restructuring plan, backed by signed contracts, substantiated the bank's decision.

Workers' wages could not be paid on time. The whole community was terrified by the immediate threat that the mine would be closed. A local priest said a mass in anticipation of Maron's return. Karcz and his supporters were put in the coal carts by an angry mob of miners and driven out the Rainbow grounds. The next day, Karcz sent his resignation, which was accepted. A delegation of miners visited Maron's house and asked him to return to his duties.

After a day of hesitation, Maron accepted. A newly elected (again!) workers' council approved his restructuring plan, which enabled him to sign the contract with Anderson-Longwall and Shell—which, in turn, resulted in the resumption of financing for Rainbow's operations. The Minister of Industry created a special commission to inquire into workers' council activities under Karcz's presidency. As of March 1991, the restructuring plan was off the ground again. But the foreign partners started to have second thoughts, and exactly a year was wasted—making Rainbow's situation even more critical than before.

*SovTruck.* The next description of a typical communist dinosaur faced with contemporary challenges comes from the former USSR. "SovTruck"<sup>2</sup> is a dinosaur typical of the Soviet automotive industry. In 1989, it employed 120,000 people in 15 plants and produced more than 200,000 trucks annually—a quarter of the total Soviet production volume. SovTruck is an almost completely self-sufficient and fully integrated truck manufacturer, that performs all of the key production operations, from raw casting to finishing. It also produces wide range of appliances, such as refrigerators, kitchens, and microwave ovens. SovTruck has its own hospital, technical schools, network of factory stores and canteens, research and development institute, vacation centers, and apartment complexes.

In contrast with similar enterprises in highly developed market economies, big Soviet enterprises contract out as little as possible and try to do everything themselves. This leads to unused production capacity in many areas, prevents the factory from getting top-quality components from highly specialized suppliers, and considerably increases the production costs per unit. It also diverts the attention of the managers from key issues. This tendency results from the chronic lack of reliability of domestic suppliers, the nonconvertibility of the currency, and the bureaucratic rigidity of the planning process. In such an environment, a high degree of self-sufficiency (meaning, in fact, autonomy and independence) is considered to be one of the key factors of the enterprise's prestige and success—especially since production costs were neglected to the extent that (as the author's interviews with Soviet managers indicate) production costs per product and per unit were not even calculated.

Labor shortage has always been one of the most difficult problems facing socialist enterprises, especially in big industrial centers. Up to the end of 1990, only those countries more advanced in the transition process, such as East Germany, Poland, Hungary, and Czechoslovakia, had started to experience unemployment problems to different degrees.

In Russia, unemployment was unknown until the end of 1991. The labor shortage was due to very strong tendencies toward over-employment. It is author's estimate that an enterprise similar to SovTruck, operating in a highly developed market economy, would employ less than one-third of SovTruck's work force. Over-employment resulted, in turn, from low labor productivity (due to outdated and poorly maintained equipment, irregular inflow of input, and poor organization of work), from the high proportion of administrative jobs (due to the high degree of bureaucratization of the overall economic system), from the wide range of unrelated and auxiliary activities (where labor cannot be used efficiently), and from high absenteeism, turnover, and lack of work discipline.

Enterprises in the big industrial centers competed to attract and maintain the better workers. Since wages and rates were closely controlled administratively, activities providing for the workers' welfare were the only means of appeal. Enterprise housing was the most attractive, along with—under conditions of severe shortages of consumer goods—factory shops and services. Recreational and medical services also played a role. Enterprises enjoying high prestige and high visibility developed such activities very intensively, which in turn helped them to foster even more prestige and visibility. It is clear that social welfare activities not only increase costs, but also create new needs to employ new people. The vicious circle of over-employment can be observed when: a work force deficit creates a need for development and the extension of social services, which in turn creates new sources of labor shortage. The SovTruck example, where on any given day up to 10 percent of the work force might be absent, clearly illustrates this argument.

Vlachoutsikos and Lawrence (1990) describe a process of appointing managing directors in one of the factories situated in the main Moscow complex of SovTruck. In 1989, factory X produced 900 gasoline engines a day and employed about 2,300 workers (450 of whom were part-timers, because of the labor shortage mentioned previously). Factory X received its production targets from the central management of the Moscow complex, and coordinated the main assembly line with the production of components.

The job of the factory manager was to ensure that these targets were met. It was not an easy task—not only due to the shortage of labor, but also because of the run-down equipment. There existed a long-range plan

to convert the factory to production of diesel engines—but it did not materialize for years, and the old equipment was not properly maintained and replaced. In such a situation, an effective manager of the factory had to possess both technical and human skills.

The factory manager since 1981, Mr. Ptichkin, performed well for a couple of years. But around 1985, he could no longer handle the technical problems related to deteriorating equipment, in addition to personnel problems such as absenteeism and the shortage of labor. Ptichkin had to be replaced because factory could not fulfil its production plans.

He was replaced, in 1986, by Mr. Priakhin—who even received some assistance from headquarters, in the form of new equipment and an increased wage fund, which enabled him to pay better wages and hire new workers. These resources did not help him enough, however, and Priakhin resigned in 1988 following a conflict with the workers over compensation for overtime he was trying to force them to put in.

In 1987, the new enterprise law was enacted by the Soviet parliament, giving the workers' council the power to elect managers—who had to be confirmed, however, by SovTruck headquarters. The vacancy left by Priakhin was filled by workers' council candidate, Mr. Tumanov, who was popular among employees because of his activities as union representative. Headquarters had his own candidate, Mr. Gorian, and raised objections related to Tumanov's insufficient technical knowledge (he was not an engineer, but a mere mechanic). Under pressure from the workers' council, however, headquarters decided not to force its own candidate. Tumanov was approved—but after a relatively short time, it became evident that he really was not qualified for the job. Tumanov understood this himself, and handed in his resignation. This time the headquarters candidate, Gorian, was elected—and with headquarter's support (e.g., new, more reliable equipment that enabled him to keep to schedules and improve quality) he performed relatively well.

Both cases presented above enable us to draw some general conclusions covering the whole population of dinosaurs in post-communist economies.

All the issues related to the “dinosaurs” are highly political because of two reasons:

1. “Dinosaurs” were created by communist regimes as strong political entities with large and important party and trade union organizations. Political factors always played an important role in their functioning (for example managers were always political appointees called “nomenklatura”). The same patterns tend to be repeated in the new situation with new political forces (such as new political parties which emerged from “Solidarity” in Poland) and new institutions (such as workers' self-



management councils technically entitled to participate in management including the process of selection of managers).

The new situation of disintegration and collapse of the communist system creates strong uncertainty and strong emotions. These new tensions can be attributed to the strong resentment of the old nomenklatura and the new opportunities and the new perspectives of promotion discovered by new people. Complete lack of institutionalized industrial democracy tradition makes these tensions highly destabilizing and provides for even more uncertainty.

Appointments of managers tend to become emotional issues concentrating all hopes, ambitions, animosities and hates. It can easily lead to the waist of the most scarce resource: existing managerial talents and experience often possessed by the people related to the "old regimes". It also creates very insecure situation for the managers. "Over-democratization" of the big state owned enterprises in the post-communist countries is clearly evident. It takes form of a "populist industrial democracy" (discussed below in the Chapter V). Different countries experience it to different degrees.

Poland with its 12 years long tradition of militant "Solidarity" backed workers councils seems to be an extreme case. Problems of workers council interference with the management process is clearly perceived as a threat by the government. Polish minister of industry declared in an interview in March 1991 that intended transformation of the legal form of the state owned enterprises into joint stock companies wholly owned by the state treasury has two objectives: to prepare grounds for privatization and to eliminate workers council (not allowed in joint stock companies). Even if this operation will be fully successful two or even more trade unions competing on the enterprise level might complicate enough management process.

Ex-USSR republics facing explosive political issues have inherited an old tradition of political activism on the enterprise level. In a political tradition of the Russian empire democracy is often understood and practised as a synonym of anarchy and order as a synonym of tyranny. In such a context "over-democratization" problems seem to be especially serious.

In Czechoslovakia workers councils were introduced by the communists in the last attempt to save the system through partial populist-minded reforms. Because of that communist inspiration they never became a real factor and were relatively easily removed in 1990. Trade unions, however, and other workers political organizations seem to be quite active in the big state-owned enterprises endangered by "shock treatment" and restructuring processes, especially in Slovakia.



Hungary, as the only country practicing “gradual transition” and capitalizing on earlier communist reforms, had for a relatively long time been clearly inclined toward a technocratic model of management—and has always discouraged political activism on the enterprise level. Such an attitude on the part of government and management saved most Hungarian enterprises from the worst problems of “over-democratization,” despite the fact that workers’ councils are also required by law in Hungary.

Massive, emotional and often disorderly participation of workers in the management process seems to be a characteristic feature of post-communist dinosaurs during the transition period—before better organized institutional forms of worker participation and industrial democracy eventually emerge. Institutions of industrial democracy will certainly differ from one country to another according to tradition, cultural differences, and different experiences. During a period of systemic transition, people tend to experiment with newly acquired democracy on the enterprise level, too. Dinosaurs are the most likely places for such experiments because of their large concentrations of blue-collar workers, a tradition of political activism (both communist and anti-communist), and the dinosaurs’ clearly endangered position in the process of industrial restructuring.

A second reason for the highly political character of the dinosaurs in post-communist economies has to do with their role in the economy, and their competitive position on domestic and international markets. The analogy with “smokestack” industries in the West is visible. In some countries and in some industries, restructuring triggered violent conflicts, such as famous British coal miners strike of 1986. The differences are rather evident as well.

Post-communist economies are characterized by under development of modern high-value-added industries, and even more so of agriculture and the tertiary sector (i.e., services, retailing, banking, insurance). It means that the relative importance of dinosaurs is greater, and that the rest of the economy is not able to generate the resources necessary for restructuring and for cushioning the social shock. Such a situation rules out the rapid elimination of dinosaurs. The east German experience of 1990 and 1991, and especially the wave of strikes and social unrest in the spring of 1992, show that even the strongest European economy cannot afford—economically, politically, and socially—the sudden elimination of dinosaurs.

In the highly developed western countries, heavy industries and the regions where they are located (as well as the militant trade unions) were gradually losing ground. Political scenes of these countries were always dominated by middle-class politics. In post-communist countries, middle

classes are nonexistent. Moreover, in some of these countries (e.g., Poland, Russia) blue-collar workers employed in the dinosaurs, and their free trade unions, played an absolutely decisive role in weakening and removing communist regimes.

In all the countries of the region, however, no matter how important or unimportant the role of blue-collar workers in the overthrow of communism, the relative political role of dinosaur workers is much greater than it ever was in the West. Since transition inevitably hurts them, both communist and extreme right-wing elements are likely to seek their support, and to exploit their bitterness. Bitterness results from the sudden change of the situation—as yesterday's pools of "socialist economic development" are transformed into the most depressed regions, and the "workers' aristocracy" or "avant garde of communism" into the unemployed.

Low income levels, in absolute figures, and the difficult conditions of life (e.g., ecological catastrophe) of the workers employed by the dinosaurs, make this situation even worse—taking into consideration the extremely low, practically nonexistent labor mobility. Political results are already visible. In the Slovak town of Martin, where 16,000 workers are employed by a tank factory. The Communist city council and mayor were democratically elected in 1990, and still enjoy massive popular support<sup>3</sup>. In Polish Silesia in the fall of 1990, miners and steel workers voted overwhelmingly for a rightist demagogue presidential contender, Mr. Tyminski, who came to Poland from Canada and Peru. After a campaign of less than two months, Tyminski was able to challenge the legendary charismatic leader, Lech Walesa. In East Germany, both the fascists and the communists are on the rise.

It is relatively easy to discover that virtually all the post-communist dinosaurs are many times over-staffed, technologically backward, polluting the environment to a degree intolerable by objective biological standards, and hopelessly losing their traditional markets (the Soviet bloc military complex or, until recently, the "easy" COMECON markets). Their only asset is highly qualified and cheap labor including bright and well-trained engineers. By and large, dinosaurs are unable to compete on international markets. Only a relatively low percentage of them can be rescued by "Rainbow"-type therapy—including massive capital investment in new technology and equipment, adjustment of output to the standards acceptable to international markets, and massive layoffs. Only very few of the dinosaurs can attract foreign investors. Over-democratization, generally hostile attitudes of the workers toward foreign ownership, and the highly political character of the issues related to transformation of such enterprises, are certainly among the reasons substantiating this statement.

For example, in November 1991, Warsaw Steel Works (closed since the previous August) was sold to an Italian group, Lucchini. Although the factory was sold to a European steel industry leader for a very good price, including a minimum \$250 million investment by a foreign partner, the deal was temporarily blocked by the workers' council because of the lack of employment guarantees. Experts believed that the sale was the only chance to save the steel works, and finally the deal went through<sup>4</sup>.

Do these statements mean that the dinosaurs will be quickly eliminated? Certainly not. None of the post-communist countries could afford it, either economically or politically. Some kind of long-range industrial policy will have to be worked out that calls for the gradual elimination of dinosaurs, creation of new jobs in depressed regions, and massive modernization of a few factories carefully selected as the most promising.

Realistically assessing situation, funds for such a restructuring program can come from two sources: the state budget, or foreign help allocated for such purposes by organizations such as the World Bank or the EEC. In both cases, government will have to play a significant role in the formulation, implementation, and securing of financing for such a policy. This would require, in turn, a deep transformation of government bureaucracy from the old model to the new one.

The old model, inherited from the communist bureaucracy, was based on daily interference of the government agencies and party apparatus with the functioning of the enterprises, combined with patronizing them: "protecting" from threatening environment, securing resources to enable the "dinosaurs to survive. Such an approach means nothing more than further promotion of the waste of resources.

The new model, practised in Western Europe and in newly developed countries of Far East, means industrial policy. It requires radical change in the government structures, skills and mind-sets of the government officials. Such reforms were undertaken only in Hungary in the 1970s, and in the '80s by the "last hour" communist reformers. Central planning in physical units was eliminated, and all sectorial ministries were consolidated into one policy making agency. Such reform brings results. Hungary was able to practice a reasonable "gradual transition" strategy, and to find relatively easily a "common language" with corresponding agencies in Western Europe, both on national and supra-national (EEC) levels.

In the countries practicing "shock therapy," all government intervention in the economy seems to be associated with the old model—and is considered contradictory to "textbook principles" of the market economy. These attitudes, however, will inevitably change under strong political pressure from the dinosaurs. Under such pressure, the Polish government in 1992 had to soften its position considerably toward falling

dinosaurs (at least the most politically explosive, such as the Ursus Tractor Works in the Warsaw suburbs). Vice Prime Minister Balcerowicz, responsible for the “shock treatment” policies, had to go. Czechoslovak President Vaclav Havel could not live up to his early promises to completely withdraw his country from international arms deals. The same applies to Russian President Boris Yeltsin. In 1992, the Russian government did not dare to start massive closings of dinosaurs, in spite of pressure from the International Monetary Fund. Unfortunately, Russia did not have a comprehensive restructuring plan, either—the new dogma of an abstract “free market economy” prevents it.

### *Pretenders*

Pretenders are state-owned enterprises that were able to develop, under communist system, a product mix responsive to the requirements of contemporary market economies. These companies built a name for themselves and established commercial contacts in the West. Such enterprises are considered prime candidates for privatization, foreign capital investment (both direct and portfolio), and further expansion in the emerging market environment. Since the number of pretenders is relatively limited in the post-communist countries, they are able to attract management talent. Usually they also build on local reserves of highly trained workers. At the same time, however, transition confronts the pretenders with previously unknown challenges—which they often have problems confronting. Typical problems facing the pretenders will be presented here with the help of two examples: Gold Mark S.A. in Poland, and the Star department store in Hungary.

Gold Mark was created<sup>5</sup> in 1945 in the Polish textile industry town of Lodz, sometimes called the “Polish Manchester.” The outfit was established to produce clothing for the army. Starting in 1949, Gold Mark expanded its production and sales to include men’s winter and spring overcoats sold on the internal Polish market. In 1956, when capital investment in new buildings and equipment made further expansion possible, Gold Mark began to specialize in all-season men’s garments.

By the end of the 1950s, exports to the Soviet Union had started. Further export orders came from West Germany, France, England and the U.S. In the ’70s, new production facilities were acquired in the Lodz region (smaller enterprises administratively incorporated into Gold Mark by the Ministry of Light Industry) and the new factory building in Lodz was completed. Gold Mark’s considerably increased production capabilities made possible deeper penetration of foreign, mainly Western, markets. In

1991, Gold Mark had major clients not only in the Western countries previously mentioned, but also in Great Britain, Denmark, Finland, Italy, Canada, Sweden, Holland, Australia, and Belgium. In short, the company covered all of the most difficult and discriminating markets. During the last couple of years, Gold Mark's volume of exports to hard currency markets consistently exceeded \$10 million per year. Exports accounted for 31 percent of the company's sales in 1989, and jumped to 69 percent in 1990.

This dramatic change was, in part, due to the introduction of the new exchange rate, which strongly devalued the local currency. Devaluation was part of the "stabilization plan," introduced on January 1, 1990, known as the Balcerowicz Plan (for the viceprime minister responsible for economic affairs in the first non-communist Polish government). The Balcerowicz Plan provided, among other things, for "internal convertibility of the currency." Internal convertibility means that local currency can be freely exchanged for any foreign currency inside the country—but it still cannot be used as a means of payment outside the country, and is not quoted on the international currency markets.

Gold Mark built a reputation as a high quality manufacturer by targeting the upper segments of the market. It won a considerable number of prizes at international clothing fairs and exhibitions.

In spite of the attention it focused on lucrative foreign markets, Gold Mark has the most prestigious trademark in garments on the Polish market. It still controls more than 25 percent of the men's winter overcoat market, and 38 percent of the men's spring overcoat market. Gold Mark has a smaller share (5–10%) of the markets for men's short jackets and women's overcoats.

Poland, with its population of 38 million can be considered a major market for garments—even if, under "shock treatment," demand has fallen because of the drop in purchasing power of close to 30 percent. Garment prices have risen slightly less than prices in the economy as a whole, but have still exceeded the growth rate of per capita income. In 1985, the average monthly salary could buy five men's spring overcoats made by Gold Mark—but only 3.3 coats in 1991. In 1989 Consumers spent 17 percent of their income on clothing in 1989—but only 9.5 percent in 1990. At the same time, however, the emerging middle class in Poland and other Eastern European countries is offering new opportunities for high quality men's garment manufacturers, such as Gold Mark.

Gold Mark's foreign customers are mainly big retail chains, such as C&A, or wholesalers specializing in garments, such as Bourges in France. Fifty-one percent of the company's exports, by volume, and 29 percent by value are made under "cut, make and trim" (CMT) contracts. The sales manager of Gold Mark, Mr. Kowalski, believes that such contracts are