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Institutional and Organisational Dynamics in the Post-Socialist Transformation

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Post-socialist transformation and the emergence of the "institution problem"

The transformation of former socialist economies into capitalist market economies implied a radical change of institutions as well as a deep restructuring of existing organizations and - obviously - the creation of new ones.

"Institutions matter" is certainly one of the great lessons of this exceptional systemic change. Indeed, since 1999, several reports, focused on institutions and the way they are decisive to sustain growth and development, have been published by international organizations [UNECE 1999 and 2001, EBRD 1999, World Bank 2002]. Still, it is important to point out that at the beginning of the transition process this idea was not widely shared among specialists nor within international organizations.

The first transition-cum-stabilization programs, implemented in most Eastern European countries in the early nineties, were all - though more or less - resting on the same scheme. That is to say, as underlined by the UNECE [1999, p. 4]: "The transition to a market economy could best be made by liberalizing and privatizing the economy as quickly as possible while macroeconomic policy should establish and maintain low rates of inflation and balance in the general government and current accounts." This strategy was supposed to restore macroeconomic balances, to compel former state enterprises to restructure under the pressure of market forces, and consequently to bring post-socialist economies back on a growth path. This prevailing transformation paradigm, derived from mainstream economics, clearly underestimated the role of institutions in the functioning of "efficient" market economies.

As a few observers had predicted, the results were often not in accordance with expectations or textbook models. Unexpected actor's behaviour and the successive financial, economic and political crises occurring in Bulgaria (1996), the Czech Republic (1997), Romania (1997) and, last but not least, Russia (1998), lead to a debate on the causes of such unforeseen transformation outcomes. Today, most specialists agree (see the abovementioned reports of international organizations) on the excessive attention granted to macroeconomic problems then, at the expense of structural or institutional foundations.

The present special issue of ***East-West Journal of Economics and Business*** devoted to "institutional and organizational dynamics in the post-socialist transformation" (the theme of the 2002 Amiens conference which papers included here stemmed from) is in line with this theoretical evolution, while it also lay stress on the interaction between institutions and organizations perceived as of crucial importance in order to understand economic change. Consequently three questions deserve our attention. First, as far as transition and economic change are concerned, why and how do institutions matter? Second, what is the relation between the emergence of new institutional forms and organizational action, and what type of actors *rule-generating* strategies can be observed? Third, what is the impact on firms and sector restructuring? Of course we do not pretend to give here any definitive answer to such points but the papers of this volume shed some light on these issues and can feed future research on transition economies, institutions and organizations.

Institutions matter…

As Loasby points out in this issue, uncertainty and the limits of human cognition are crucial factors for the evolution of economic systems. All processes require structure, which in return influences their outcomes, every structure being a pattern of selected relationships. Institutions provide frameworks and organizations provide routines and decision premises.

There is no unanimously accepted definition of institutions and their content, even if North's definition is the most widely referred to[1]. One can generally find two broad institutional perspectives in the literature, reflecting a division between mainstream and heterodox traditions in economics.

Within neoclassical theory, institutions (legal limits, property rights, etc.) are traditionally considered as exogenous constraints[2]. Marshall in the *Principles* linked this exogeneity to time, given that in the long term ruling constraints could be viewed as the outcomes of attempts to minimize costs or maximize benefits. During the last twenty years, institutions have been endogeneized following the pioneer contribution by Schotter (1981) and considered as Nash equilibrium solutions of repeated no-cooperative games among substantively rational agents pursuing their utility maximization goals[3]. In more applied works (for example, World Bank, 2002) institutions appear decisive for supporting markets and increasing competition, for the definition and enforcement of property rights and contracts, for the diffusion of information

[1] "Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics." [North, 1994, p.360].

[2] Rules of the game as external constraints are also the main issue of the *law and economics* program developed in the 1960s and 1970s (Demsetz, 1967; Alchian and Demsetz, 1973).

[3] A. Schotter defines social institutions as a "regularity in social behavior that is agreed to by all members of society, specifies behavior in specific recurrent situations, and is either self-policed or policed by some external authority" (Schotter, 1981, p. 11). An institution is a self-enforcing state from which agents are not motivated to depart as long as others do not do so. See also Eggertsson (1990) and Aoki (2000).

about market transactions, hence for the reduction of uncertainty in exchange; in short, for the efficient distribution of resources.
Heterodox tradition is inspired by the old school of institutional economics (Veblen, 1898; Commons, 1931), evolutionary (Nelson and Winter, 1982; Hodgson, 1993 and 1998; Loasby, 1991 and 2000) and/or socio-economic approaches (Granovetter, 1992; Grabher and Stark, 1997)[4]. These characterize institutions as social constructs and insist on their social embeddedness, as well as the cognitive limits, asymmetries and conflicts that contribute to their consolidation. They also emphasise a number of parameters, such as: the role of networks, the complementary character of various institutions, the diversity of national institutional configurations, and their path-dependent evolution with the possibility of institutional lock-in to inferior solutions (but also underlining that successful change requires 'good continuity'). Most of the contributions gathered in this issue are sensitive to this kind of approach.

Concerning institutional change in particular, Loasby draws attention to the fact that responses to uncertainty include conservatism, mimetic behaviour, and experimentation. According to Chavance, the enduring national character of the state, of the polity with its underlying social relations and compromises, and of the legislation (formal institutional rules) largely influenced features of the process of organizational, institutional and systemic change. These different factors, furthermore, lead to various national trajectories of post-socialist transformation. Magnin compares transformation processes in Hungary and Romania, insisting on the path-dependent character of their trajectories and the importance of initial conditions. Based on a field research in Romanian agriculture, Amblard, Simon and Colin also underline the path-dependence factors (resource endowments, constraints linked to the implementation of institutional reforms and organisational choices made just after the restitution) and the impact of the change of formal institutional rules to the organisational and contractual practices.

Of course, despite important methodological differences, boundaries between mainstream and heterodox approaches are often pervious[5]. What more, most specialists from both perspectives would agree that, from a macroeconomic

[4] Austrian tradition (Hayek, 1973) supporting the view of institutions as "spontaneous order" and endogenous rules of the game, could also be considered as "heterodox" concerning the rationality model of individuals. But it suffers from an inherent difficulty to establish the link between individual choices and collective order.
[5] Some contributors to new institutional economics - North in particular - could be related to both approaches.

standpoint, institutions together with technology notably define the characteristics of the financial, education and welfare systems, which influence capital (both physical and human) accumulation and hence economic growth. From a microeconomic point of view, institutions provide opportunities, incentives and constraints, influence individual behaviour, "define and limit the set of choices of individuals" [North, 1990, p.4]. They also help to promote cooperation among individuals, reduce opportunistic behaviour, and hence contribute to solve coordination problems.

… So do organizations

Still, the importance of institutions must not lead to forget organizations. If institutions provide frameworks, organizations provide routines and decision premises[6]. Because of the complexity of social relations, the multiplicity and generality of institutional rules, and the existence of contradictory interests, organizations maintain an important autonomy and have the possibility to choose options or deviate from institutional messages. They can also influence the institutional framework according to their bargaining power. In this sense institutions are vehicles of asymmetric relations. What more, their consolidation depends on the structures and procedures (that means organizational devices) which materialize their normative, rule enforcing and cognitive attributes.

For these reasons it is important to analyze the features and strategies of both "rule-takers" and "enforcers".

Yakovlev explains that under certain conditions it is not profitable for regional governments in Russia to suppress tax evasion. Indeed, the decrease of regional tax rate can lead to a decrease of subsidies and financial transfers from central government. Therefore a better instrument for the region to attract a taxpayer is the modification of the informal tax regime. Taxpayers are informally allowed not to pay a part of regional and federal taxes and regional governments rather than choose between high or low tax rates, choose whether to suppress or ignore tax evasion. Thus weakness of the federal government enforces opportunistic behaviour of regional governments and eventually leads to tremendous losses,

[6] "It is the interaction between institutions and organizations that shapes the institutional evolution of an economy. If institutions are the rules of the game, organizations and their entrepreneurs are the players."[North, 1994, p. 361] The clarity, if simplistic, of this approach makes it the basis of most contemporary studies on institutional change.

primarily on the federal budget. Moreover, massive tax evasion occurs even without corruption of taxation authorities or regional governments.
Maroudas and Rizopoulos define the specific structural features of the Russian manufacturing firm during the first years of systemic transformation. Faced with radical economic and institutional uncertainty, the incessant renegotiations process between the various participants of the internal and external organizational equilibrium's terms, is at the origin of a robust triad (labor hoarding, networking and barter). Its reproduction constitutes a major element of the pursued strategies - at least, till 1998 - and determines both the functioning of markets and industrial relations.

Focusing on the East German transformation, Labrousse analyses industrial relations and work organisation within firms. The “overnight” transplantation of West German formal institutions can be contrasted with the potentially time-expensive change of organisations and informal institutions. The interplay between formal and informal rules has led, in East Germany, to original hybrid combinations, that is, functioning processes which are neither reducible to the West German system nor to Eastern legacies.

As far as the interaction between institutions and organizations is concerned, the issue of corporate governance (Dallago, Dolgopiatova) is of crucial importance since it plays the delicate role of the interface between the two. Corporate governance is generally related to the set of organizations and rules involved in the control of the efficient use of resources within firms. It traditionally includes ownership structure, board of directors, bankruptcy laws, disclosure laws, corporate and accounting laws, auditing firms, rating organizations, financial intermediaries, trade unions, etc. Changing mechanisms of corporate governance can contribute to force financial and industrial firms to restructure, parallel with assets control and redistribution between insiders and outsiders. In return, the adaptation strategies of firms in their new environment at the microeconomic level lead to "bottom-up" institutional changes. Indeed, privatization programs often have unexpected outcomes (diversion of resources by coalition of private interests) and produce a diversity of models of corporate governance (Dolgopiatova).

Avdasheva studies specific contractual practices (tolling) on input supply. Empirical evidence from several homogenous industrial products of the Russian industry supports the view that tolling is a mean of entering the market by new firms and/of restructuring. Indeed tolling can be considered as a vertical quasi-integration making the acquisition of refining capacities unnecessary. Control over input supply helps a new entrant to reduce sunk costs and it enables the supplier of input to increase profits.

Restructuring constraints and strategies

Institutional changes in transforming economies have a strong impact on the behaviour and development of firms. They have created a new environment for entry and competition for *de novo* companies, former State-owned enterprises and foreign competitors. Industrial restructuring, along with privatisation of state assets has been a long and painful process in almost all countries that have inherited a strong and distorted industrial structure compared to the industrial organization of developed market economies. In many of these countries, new enterprises have soared, often small and medium, while governments had to cope with the management, control and financing of big firms with an uncertain future given the new economic environment. Building new social networks, externalising productive assets and social services, developing new incentives has been challenging. Companies with less asset specificity, needing less capital and closer to final demand have been easier to restructure, while companies needing more capital and technology have been slower to adjust. On the other hand, foreign companies, when allowed to enter these new markets, have been active either through acquisitions or green field investments. Most of these investments have created spin offs and contributed to develop both new networks and, generally, positive externalities.

With reference to the Bulgarian experience, Koleva tries to evaluate the articulation between the various determinants of enterprise restructuring. She shows that change in ownership and hardened budget constraints do not act necessarily in the same direction, with respect to restructuring, and are, furthermore, dependent on the quality of institutions and on the degree of domestic and foreign competition. Indeed, according to Richet, the pace of restructuring of the Russian car industry depends on the implementation of two alternative models: conglomerate control versus cooperation with foreign firms. Actually, the local actors (government and carmakers) have an ambivalent position concerning the presence of foreign companies. If foreign direct investment could help to restructure and to fill the technological gap, the shock of industrial restructuring and its social, economic and regional issues could be damaging. The question of the control of strategic assets seems to be a focal point, bringing the Russian government to decide between supporting its national industry and opening the market to world competitors. In a different context, Wang stresses the link between policy regulation and the performance of foreign investors in the Chinese car industry. The main question concerns once more the possibility of the Chinese policymakers to enhance the positive contribution that MNCs bring to the local automobile makers, while avoiding damaging consequences. Last, Durand draws a picture of the Russian metallurgy crisis, caused by the liberalization shock, which induced rising transactions costs on the domestic market and a spectacular growth of exports, at the expense of the internal industrial coherence. After a decade of struggle for control, the process of corporatist stabilization initiated in 1998 and the significant growth of production create a new situation which, meanwhile, do not necessarily imply a sustainable development.

The collection of papers published in these issues of the ***East-West Journal of Economics and Business*** addresses some important issues, both theoretical and practical that have stemmed from the transformation process that has occurred during the last twelve- thirteen years in post-socialist economies. They highlight important theoretical points; on the relevance of institutional economics to explain how economic systems can change, why specific trajectories are selected, why pre-conceived institutional designs have not been implemented, and how unforeseen institutions have emerged alongside with the development of the new organizational and market environment.

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