

## Necroeconomics of Post-Soviet Post-Industrialism and the Model of Economic Development of Georgia and Russia

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**Abstract:** In post-Soviet economies, the decrease in the share of industry was not due to the growth of high-quality innovative services but, rather, an immediate decline in industrial production. Following the collapse of the Soviet Union, the large-scale deindustrialization of the Russian (and the entire post-Soviet) economy took place, resulting in many sectors and industrial enterprises being lost. The reason for this was the phenomenon of “necroeconomy” which combines so-called dead enterprises (because of the inability to produce competitive goods) and is the result of the negation of competition in a command economy. The difference in approaches to government support of necroeconomic enterprises in Georgia and Russia mostly stemmed from the fact that the Georgian state, unlike Russia, possessed significantly limited financial resources, including for the purpose of maintaining these dead enterprises. It has been shown that both in Georgia and Russia, essentially identical consumer models of development of poor countries have established. In order to transfer to an innovative model of economic development, it is essential to stimulate the interest of the private sector of the economy and, towards this end, the exchange of relevant experience would prove mutually beneficial.

**Key words:** necroeconomics; post-Soviet post-industrialism; consumer models of development; poverty; supply stimulation

**JEL codes:** O14, O57, P23, P31, P52

### 1. Introduction

The problem of the selection of the model that would ensure sustainable economic development is one of the most relevant issues both for economic theory as well as for economic policy. Unfortunately, it should be noted that the generally accepted model of economic development, based on innovation economics, was gradually supplanted by a model of financial economics (Gorodezkyi, 2013b, p. 67), which eventually led to a global financial crisis, escalating into an economic crisis. As a consequence, the modern world, especially due to the financial and economic crisis, continues the search for a new model of economic development.

Not surprisingly, this problem is no less of a concern of the post-Soviet countries for which the focus on an economic model that would ensure sustainable development has been — and remains — one of the most critical in the process of transitioning to a market economy.

Economic growth in the post-Soviet period, both in Georgia and in Russia, was characterized by unevenness

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(e.g., Aganbegyan, 2011; Papava, 2011a).

In researching the problem of economic relations between Georgia and Russia in the post-Soviet era (Papava, 2010c), as well as the evolution of these relations (Papava, 2011b), especially against the background of the recent Russian-Georgian conflict (Papava, 2012), the comparative analysis of existing models of economic development acquires considerable importance.

The *purpose* of the paper is to investigate the economic problems of the post-Soviet post-industrialism and to study the peculiarities of the economic development of Georgia and Russia in the post-Soviet period and compare the prevailing models of economic development in order to identify priority tasks, the resolution of which should facilitate the transition to a new model of sustainable economic development.

## 2. On the Features of “Post-Soviet Post-Industrialism”

Unlike the conventional content (which has already become classic) of the concept of “post-industrial society” (Bell, 1976; Block, 1990; Inozemtsev, 1999), the deindustrialization of post-communist countries, with some irony, could qualify as “ugly post-industrialism” and, rather, as “post-Soviet, post-industrialism”.<sup>1</sup> The fact is that in these economies, the decrease in the share of industry was not due to the growth of high-quality innovative services but, rather, an immediate decline in industrial production, in some cases, in the absence of any significant development services of the aforementioned nature.

As is known, following the collapse of the Soviet Union, the large-scale deindustrialization of the Russian (and the entire post-Soviet) economy took place, resulting in many sectors and industrial enterprises (which had laid the foundation for the Soviet economy) being lost (Gorodezkyi, 2013a, p. 72).

The reason for this was the phenomenon of “necroeconomy” which combines so-called dead enterprises (because of the inability to produce competitive goods) and is the result of the negation of competition in a command economy (Papava, 2002, 2005). Naturally, necroeconomy in itself does not exist in a healthy market economy system since the operation of non-competitive enterprises leads to the impossibility to sell their products, resulting in the insolvency of these enterprises, which ultimately leads to their bankruptcy.

Due to the fact that necroeconomy was conceived in the bowels of the command economy and the post-Soviet experience of transition to a market economy has shown that the process of this transition could not rid the economy of the dead enterprises, the established societal system can be described as post-communist capitalism (Papava, 2005; Papava, Beridze, 2005).

As recorded in the first years after the collapse of the USSR, the economic downturn both in Georgia and Russia was largely determined by the necroeconomy. In particular, potentially dead enterprises, while continuing to operate in the non-existent mode of command economy, led to their warehouses being loaded with non-competitive goods; the impossibility, in principle, of their sale resulted in the accumulation of nonpayment of wages, bad debts to the national budget, social funds, the energy sector and other enterprises. This gave rise to a tangled web of mutual debts of enterprises (Åslund, 1995, pp. 256-264; 2002, pp. 244-248, 328-330, 333-337).

The absence in the post-communist (and not only) countries of effective bankruptcy legislation (Claessens, Djankov, Mody (Eds.), 2001), as well as a lack of the political will of the respective governments to adopt and engage a capable of functioning bankruptcy law, led to the preservation of the dead enterprises.

Due to social instability from the very beginning of the transition to a market economy, there was a danger of

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<sup>1</sup> The new phenomenon of “post-socialist post-industrialism” is described in the article by Gorodetsky (2013b, p. 68).

mass bankruptcy of Russian companies as a result of which Russian bankruptcy legislation was practically inapplicable (Sokolin, 1997, p. 168). In turn, state aid to enterprises of the necroeconomy allowed them to continue their operation (Lindsey, 2002, pp. 126, 153; Shleifer, Treisman, 2000, pp. 106-107).

Although in Georgia, in the absence of effective bankruptcy laws, there have also been attempts by the government to maintain the necroeconomy but the liberalization of foreign trade policy (Papava, Beridze, 1996/1997), coupled with the scarcity of public resources, led to an actual shutdown of many dead enterprises (Papava, Tokmazishvili, 2007).

It should be noted that the difference in approaches to government support of necroeconomic enterprises in Georgia and Russia mostly stemmed from the fact that the Georgian government, unlike Russia, possessed significantly limited financial resources, including for the purpose of maintaining these dead enterprises.

However, in times of the absence of crises in large countries (such as Russia), the problem of necroeconomy is less acute than in relatively small countries (such as Georgia), since necro-enterprises, due to the large scale of their economy, with government support, have the opportunity to compete amongst themselves (Schaffer, Kuznetsov, 2008) which creates the illusion of the absence of necroeconomy. In small countries, the problem is more acute since for many necro-enterprises there are simply no other analogues within the country (Papava, Tokmazishvili, 2007).

Because of the relatively smaller-scale necroeconomy in 2009; i.e., in the midst of the global financial and economic crisis, the downturn in the economy of Georgia, compared with the decline in Russia, was much more moderate (WB, 2014). This is not surprising since it is in the conditions of financial and economic crisis that necroeconomy makes itself felt via a significant decline in industrial production caused by a moral depreciation of plant of necroeconomic firms concentrated in industry (Illarionov, 2008a, 2008b).

It must be emphasized that in the context of the global financial and economic crisis, measures taken by the governments of Georgia and in Russia (Papava, 2010d, pp. 45-48, 54-58) did not substantially differ from those that were commonly used in post-communist countries (Papava, 2010a, 2010b, 2010e), as well as throughout the world (e.g., Harman, 2010; Onaran, 2012; Quiggin, 2010), and are based on the Japanese miserable experience of the zombie economy (e.g., Ahearne, Shinada, 2005; Hoshi, 2006; Hoshi, Kashyap, 2005; Smith, 2003); i.e., the preservation of non-competitive firms that have turned into such due to the crisis. The difference between these countries was only in the scale of state support to firms on the verge of bankruptcy.

### **3. On the Consumer Model of Economic Development of Poor Countries**

In describing the current model of economic development of Georgia and Russia, it is necessary to emphasize that despite the fact that there are significant differences between them, these models are largely similar. Let us consider the models separately.

#### **3.1 Georgia's Model**

While referring to the pattern of economic development in Georgia, it must be highlighted that for over 20 years of independent statehood, the issue of choosing a path of development has always remained topical for Georgia (e.g., Beridze, 2009; Gogolashvili, 2011; Papava, 2013c; Samson, 2006).

The current model of economic development of modern Georgia, unfortunately, is based not so much on production growth but, rather, on *stimulating consumption*.

Stimulating consumption without proper development of real economy has led to the fact that in recent years,

import has been three times greater than export (Geostat, 2014).

The focus of the Georgian economy on consumption, rather than on production, is also evidenced by the fact that the total volume of private and public consumption equals approximately 90% of GDP (Samson, 2008, p. 73).

With the relative backwardness of production, growth in consumption is ensured due to the inflow of funds from abroad: in the first years after the Rose Revolution, this was primarily carried out through foreign direct investment (FDI) (e.g., Shmidt, 2007) and remittances to Georgian citizens conducted by their relatives living abroad (e.g., Kakulia, 2007).

As a rule, FDI was accumulated in real estate which generally created additional financial resources within the country. This financial resource, incoming mainly via the banking system, contributed to the growth of residential construction which, in the absence of proper government regulation, progressed into the well-known “financial pyramid” or “Ponzi scheme” (Papava, 2010d, p. 46).

After regaining independence, many residents of Georgia left the country for one reason or another. To date, about 20% of Georgia’s population (more than one million people) reside abroad (of which two-thirds are located in Russia) (Samson, 2008, p. 74). The size of remittances just through banking channels annually exceeds USD 1 billion.<sup>2</sup> These funds are usually used for the purchasing of essential goods.

Following the onset of the global financial and economic crisis, FDI inflows to Georgia fell sharply. This was also facilitated by the Russia-Georgia war in August 2008. At the same time, Georgia, as the aggrieved party in the war, was offered financial assistance in the amount of USD 5.8 billion by the international community (Papava, 2008). This, for its part, ensured the possibility to preserve the consumerist nature of economic development of the country, not to mention the fact that the effects of the global financial and economic crisis were relatively tolerable for Georgia.

Orientation towards consumption with an underdeveloped real sector of the economy in Georgia led to the fact that 40% of the population found themselves below the poverty line (Meskhia, 2008, p. 57). According to estimates, 86% of the population experience serious social problems (Giorkhelidze, 2010, p. 40).

Thus, *the modern model of economic development of Georgia is the consumer model of the development of poor countries* (Papava, 2013a, 2013b).

### **3.2 Russia’s Model**

The issue of selecting a model of economic development has been and remains topical for Russia (e.g., Illarionov, 1996; Sorokin, 2010; Dobryshevsky, Sinelnikov-Murylev, 2012; Yasin, Akindinova, Yacobson, Yakovlev, 2013).

As is known, the economic success of post-Soviet Russia is mainly determined by the extraction and export of hydrocarbon resources (e.g., OECD, 2009). The Russian economy was jokingly termed a “pipe economy” (Gorodezkyi, 2013a, p. 69). Despite the fact that, especially in the pre-crisis period, the economic policy of the Russian government relied on the oil and gas industry, this sector of the Russian economy, as well as the whole real sector of economy, was in a state of conservation of deep technological backwardness (Gurvich, 2010).

In 2008 (when oil prices remained high and continued to rise), the government developed a concept of long-term socio-economic development of Russia until 2020 which was based on a more sustainable model of growth by stimulating innovation with the purpose of decoupling economic growth from the level of production of raw materials (OECD, 2009, p. 56). The implementation of this concept was primarily prevented by the onset of

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<sup>2</sup> Data on remittances published on the website of the National Bank of Georgia: <http://nbg.gov.ge/index.php?m=306&lng=eng>.

the global financial and economic crisis.

Enormous sums, accumulated in the Russian stabilization fund during the pre-crisis years of 2000-2008, were purposefully used to prevent the collapse of the banking system and the stock market which, at the same time, helped to preserve the priority of the fuel and raw materials sector in the structure of the Russian economy, aggravating its technical and technological backwardness (Gorodezkyi, 2013a, p. 70).

According to studies conducted by the Institute of Economy of the Russian Academy of Sciences, within the Russian GDP structure there was a steady trend of a negative correlation of the volume of savings and investments in fixed assets while the share of savings in Russia's GDP did not exceed 20% (which lags behind similar indicators, for instance, in Belarus, India, Kazakhstan, China, South Africa and Brazil) (Gorodezkyi, 2013a, p. 75).

The technological and structural backwardness of the Russian economy has formed a model of economic development that is categorized as the **consumerist model of development** (Gorodezkyi, 2013a, p. 75).

It is also essential to emphasize that according to research conducted by the Institute of Sociology of the Russian Academy of Sciences, nearly every third resident of Russia is virtually poor; i.e., in actuality, 30% of Russia's population belongs to the disadvantaged group rather than the 9% that is recognized officially (IE RAN, 2013, p. 159). At that, it is significant to note that the Russian type of poverty is characterized by a concentration of poor population in rural areas which, as a rule, is attributable to Third World countries (Balatsky, 2010).

Summing up, it can be concluded that the modern *model of economic development in Russia is the consumer model of the development of poor countries*.

#### 4. Conclusions and Recommendations

In the post-Soviet period, both in Georgia and in Russia, there emerged a specific phenomenon of "post-Soviet post-industrialism", the basis for which is necroeconomy; i.e., non-competitive enterprises preserved since the era of the command economy. Prior to the global financial and economic crisis, in Russia, as a country with a large-scale economy, the problem of necroeconomy was felt less acutely than in Georgia with its significantly smaller economy because due to the large scale of the economy, with government assistance, necro-enterprises have the opportunity to compete with each other creating the illusion of a lack of necroeconomy. At the same time, in small countries, this problem is more acute since for necro-enterprises there are simply no other analogues within the country. On the other hand, the larger-scale presence of necro-enterprises in the Russian economy led to a more significant economic slowdown in the crisis year of 2009 than in Georgia.

To date, both in Georgia and in Russia, there is a so-called "cartoon version of the consumerist society" (Gorodezkyi, 2013a, p. 75) as both countries have developed a consumer model of economic development of poor countries.

To create objective conditions for sustainable economic development, both countries need to rid themselves of necroeconomy since the more a country lags behind advanced technological achievements, there is little chance that increased competition within the country will accelerate the latter's economic development through ensuring high economic growth rates (Golichenko, 2012, p. 121).

In turn, in order to dispose of dead enterprises (a problem that is much more acute for Russia than Georgia), it is essential to make use of bankruptcy legislation.

In order to transfer from the consumer model of economic development of a poor country to an innovative

model, it is vital to pique the interest of the entrepreneurs themselves since solely government efforts in this regard will render very limited results which, at best, will be used by foreign partners and competitors (Sorokin, 2010, p. 32).

Thus, economic policies must be constructed to encourage (including by means of tax incentives) a private sector-oriented innovative type of economic growth.<sup>3</sup> And towards this end, the exchange of experience between Georgia and Russia can be substantively rewarding.

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<sup>3</sup> In this context, it is especially attractive for Georgia to obtain a free trade regime with the EU and the U.S. The fact is that without the technological renovation of the Georgian economy, production of competitive goods, for which there is demand in the EU and the U.S., will be impossible (Kakulia, 2014; Papava, 2013a, pp. 53-56; 2013b, pp. 7-9).

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