The Collapse of the Soviet Ministries: Economic and Legal Transformation

Avraham Shama and Sergey Sementsov

Facing a free-falling economy, the presidents of the Commonwealth of Independent States (formerly the Soviet Union), led by Russian President Boris Yeltsin, began to administer shock therapy in order to transform their economy into a market-driven economy as soon as possible. On January 1, 1992, a series of decrees by Yeltsin freed almost all prices, privatized ownership of most land, permitted privatization of collective farms, motivated privatization of all small enterprises, and enabled the transfer of almost all state enterprises into joint stock companies. A few days later, other Commonwealth states, such as the Ukraine and Byelorussia, adopted similar measures. As a result, five full years after the far-reaching concept of perestroika was put forth by Mikhail Gorbachev, 1992 seems to be the year of the acid test of the market economy in the Commonwealth. In the meantime, over 80 ministries, which had controlled the Soviet economy, collapsed. What do these changes mean to the international executive in terms of risk, opportunity, and strategy?

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Table 1. Economic Performance of the Soviet Union 1990–1991

	1990	Jan.–Jun. 1991	Jul.–Dec. 1991
GNP	−10%	−15%	−25%
Inflation	30%	60%	750%
Unemployment	30%	40%	40%

INTRODUCTION

One of the most significant reasons for the ongoing disintegration of the Soviet Union[1] has been the collapse of the Soviet ministries and the extremely poor economic performance of the Soviet economy. In 1990, the gross national product (GNP) of the Soviet Union declined by 10%. In 1991, the decline quadrupled to about 40%. Similarly, in 1990, the inflation rate was 30%, and by the third quarter of 1991 it was running at an annual rate of over 1500%. At the same time, the unemployment rate, including both real and latent unemployment, increased to about 40% by 1991. [For a summary of these statistics, see Table 1, which is based on Shama (1992).] Not surprisingly, the Soviet economy came to a grinding halt, exacerbating conditions of shortages and hoarding behavior.

This dismal economic picture of hyperinflation, unemployment, and decline in the GNP is the challenge and acid test for the market reforms of the 11 Soviet republics which joined the Commonwealth of Independent States in December of 1991. The answers to several questions remain to be seen:

- Will Yeltsin's New Year's shock therapy of freeing almost all prices, and attempting to transform almost all Russian enterprises into joint-stock companies and to privatize almost all land and collective farms succeed in transforming the Russian economy into a market economy?
- Will the similar, though less drastic, therapies implemented by the Ukraine, Byelorussia, and the other independent republics succeed in moving to market economies as was done by Czechoslovakia and Poland?
- Will the Commonwealth, the very nature of which is economic, survive the economic winter?

[1]Actually, the former Soviet Union, since the Baltic states became independent in August 1991, and other republics followed by declaring their independence. Eleven of the remaining republics (all but Georgia) joined the Commonwealth of Independent States in December 1991. Because our research began in the Soviet Union three years ago, we continue to use this term for purposes of continuity and simplicity. However, when we discuss the most recent changes, we shall use the current term (Commonwealth of Independent States).

- What will happen to cooperatives and joint ventures?
- Will the independent republics issue their own currencies?
- What will be the implications for the international executive?

The present study is an attempt to answer these and related questions, based on the authors' joint research, which began in October 1989. Specifically, the goals of this article are:

1. to discuss the collapse of the ministries and the resulting implications for a market economy;
2. to outline principles or building blocks of restructuring; and
3. to point out implications for the international executive.

THE COLLAPSE OF THE MINISTRIES

By January 1, 1992, more than 80 ministries had collapsed. A summary follows of the process leading to this outcome.

The once mighty ministries which determined the fate of enterprises and their managers no longer exist. The bureaucrats, who used to control all vital resources, are now more concerned with personal survival. The number of state and federal economic agencies (Ministries and State Committees) decreased substantially between 1985 and 1991—by the end of 1991, more than 80 ministries had been liquidated. Also drastic were the personnel cuts in these agencies. By November 1991, most of the remaining ministries had reduced personnel by as much as 30%.

These changes, however, are not only quantitative. In 1987, the visit of a deputy minister to an enterprise was an extraordinary event, which could bring some real benefits, such as extra money and promotions, or vice versa. In 1991, such a visit could bring no benefits. A minister no longer has any leverage over his enterprises. He can still cause some trouble, e.g., by refusing to issue an export license, but he is unable to help in any way.

With the drastic decline in both numbers and power of the ministries, many of the best qualified people have been leaving the ministries for more secure and better paying jobs elsewhere, often with new commercial enterprises. Those unable to make such job changes stay behind. As a result, the quality of government employees has been decreasing dramatically. Ironically, it is these less-qualified employees who are now responsible for navigating the economy through its present critical time.

At the same time, enterprises have been escaping the rigid constraints of the ministry system. In 1988, twelve enterprises in Leningrad managed to persuade Prime Minister Ryzhkov to let them leave their ministries and begin independent operations. They were followed by dozens and, later on, hundreds of enterprises in different sectors of industry and different regions of the USSR. These "free enterprises" have formed their own professional associations with different systems of interrelationship, different bylaws, and different objectives tailored to their different needs. As of January 1, 1992, as part of Yeltsin's shock therapy, almost all enterprises in Russia may choose to privatize themselves as joint stock companies. This drastic measure may also be adopted by the other republics of the Commonwealth and could speed up the pace of movement toward a market economy.

The changes in Gosplan (State Planning Committee) and its role in the industrial system are no less dramatic. There are no more Five-Year Plans, which used to dictate to all enterprises what to produce, in what quantities, and to whom to supply their products. Instead, Gosplan has been transformed into the Ministry of Economics and Forecasting, which has vastly different responsibilities. Dramatic changes have also been taking place in other state agencies, such as Gossnab (logistics), the Ministry of Finance, and GKNT (State Committee for Science and Technology).

While many ministries are collapsing and others are downsizing and changing focus, many Soviet managers are being trained in market-focused training programs. Additionally, laws to support the principles of market economy have been enacted and implemented. Whereas the central bureaucracy used to be in charge of all parts of the Soviet Union, its remnants have power now only in Russia, as the other states try to build their own administrations.

Management and Legal Transformation

At present, the vast majority of Soviet managers do not understand what is meant by a free-market economy. As a result, extraordinary attention has been given to the problems of executive education and managerial retraining. In October 1990, the Soviet government established a state-owned consortium called Management Personnel. One of the consortium's basic goals is to coordinate the activities of Soviet and Western institutions in training Soviet managers. The German government gave millions of Deutsche Marks for this purpose. Three groups of Soviet directors attended intensive programs at the London School of Economics. Sweden, Finland, Austria, Italy, Switzerland, France, and Canada are not only welcoming Soviet managers to their business schools but also to private companies where Soviet managers can learn things first hand.

U.S. participation in this process was started in 1990 by Duke's Fuqua School of Business, followed by MIT and Stanford's Graduate School of Business, and has been increasing ever since. Harvard Business School is training Soviet business school professors, and six-month internships are organized by the U.S. Department of Commerce.

Schools of business are being established in the USSR, as the market for management education has become profitable. For example, the University of Pittsburgh's Katz School of Business, which has already been offering MBA programs in Budapest and Prague, is planning to begin a similar program in St. Petersburg. Fordham University offers an MBA program in Kiev. Such schools provide not just information but, more importantly, a rational foundation for understanding the workings of a free-market economy. Soviet managers are learning that in the USSR there has always been competition for resources, people, and capital. Also, they are beginning to see that a free-market economy can keep competition fair and contribute to a just society. Such education is motivating managers and others to question the stereotypes of the command economy, although other managers, some in top positions, remain opposed to change and to different skills and the knowledge they require. Nevertheless, this trend in management education and "on-the-job training" has become much more dominant as a result of the shock therapy led by Russia and adopted by several other Commonwealth states. The next generation of managers is being raised on the basis of different ideals and a different philosophy.

Transforming enterprise managers into responsible decision makers requires not only education but also a commensurate change in the legal framework in which they must operate. The first step toward changing the legal framework was taken on June 30, 1987, when the Supreme Soviet adopted a new Law on State Enterprises (Associations). In contrast to the legislation of 1974, the new law gave more freedom to the enterprise, its management and employees. Article 10 granted an enterprise freedom to develop its own short- and long-term plans, to determine its product mix, and its suppliers and customers (see *Law on State Enterprises*, 1988). The new law emphasizes the role of the workers. Employees elect the Director or Chief Executive Officer (CEO) and the functional managers under him, subject to final approval by the ministry. In regard to operations, an employee-elected Council of Employees must approve all plans and quotas assigned to the various operational categories. For the first time in Soviet legislation, the law also provides for the liquidation of a state enterprise in case of unprofitability and insolvency.

A year later, the "old" Supreme Soviet took a significant step toward a market economy. On May 26, 1988, it adopted the Law on Cooperation, by which Soviet citizens were granted the right to organize independent cooperative enterprises. This was a break in the all-encompassing wall of the state enterprise system. Cooperatives were given the right to select areas of operation within stipulated sectors of the economy, to determine their product mixes, to hire their own employees, as well as extra workers who are not members of the cooperative, and to distribute profits according to their own bylaws without any restrictions on the level of compensation (this last issue was very sensitive with managers and employees of state enterprises). Cooperatives also received tax exemptions and deductions (see *Law on Cooperation*, 1988).

Of the foregoing cooperative rights, three had a tremendous impact on the economy: (1) the right of the owner of equity capital to receive adequate compensation; (2) the right of enterprises to hire their own labor forces; and (3) the right of owners and employees to make all decisions. These rights contravened existing state policy and practice. Opposition arose on all sides, especially from state enterprise managers, because cooperatives outperformed state enterprises and paid employees according to what they were worth. Skilled and ambitious state employees left state enterprises for employment in cooperatives. The official wage scale of the state was shown to be arbitrary, with no relation to the skills and knowledge of individual employees.

In brief, the cooperatives presented a threat to the existence of the bureaucracy, which proceeded to kill several progressive ideas by decrees of the Ministry of Finance and by local government actions. Nevertheless, the fact that the cooperatives have survived shows that the Law on Cooperation wakened a dormant entrepreneurial spirit. As of January 1, 1992, one of President Yeltsin's decrees allowed the formation of private businesses in most sectors of the economy.

In mid-1990, the Law on State Enterprises was supplemented and further revised. The intention was to identify the state enterprise more clearly in legal, economic, and social terms as incorporating the principle of self-management within a framework of state-centralized management. The new legislation gave state enterprises the following rights:

1. To operate in any sphere of business mentioned in the enterprise's bylaws and not prohibited by law.
2. To use natural resources according to Soviet legislation.
3. To sell and lease property.
4. To conduct export-import operations.

5. To issue and sell securities.
6. To establish or buy subsidiaries.

The new legislation recognized the right of private ownership of an enterprise while retaining the principle of employee participation in the decision-making process. Where previously the governing council was elected by the employees, today 50% of its members are appointed by the owners and 50% are elected by the employees. Once again, on January 1, 1992, Yeltsin by decree, allowed most state enterprises to become joint stock companies (in essence, private companies).

Legislation 1990–1992

During the 1990–1991 period, the Supreme Soviet continued the process of restructuring the legal system in a wide range of areas:

Property. *As of January 1, 1992, private property was not only allowed by also protected by special decrees. Following is a summary of the process leading to this event.*
In February 1990, basic legislation pertaining to agricultural land was adopted. It provided for the following:

1. Distribution of authority among the different levels of government: federal, republican, and local government (Soviets).
2. Establishment of rules and procedures for ownership. lease, use, and development of land.
3. Basic legislation regarding taxation and rent payments in the USSR.
4. Opportunities for development of farms, enterprises, and cooperatives in agriculture.

Under this enablement, some republics have adopted more liberal legislation. For example, on December 3, 1990, the Russian Federation adopted legislation allowing private ownership of land and the possibility of buying and selling farms with the land (see *New in the USSR Legislature*, 1990a). This was followed by most other republics in 1991.

Following the February legislation, additional legislation, adopted on March 6, 1990, defined the rights of ownership of land in the USSR (state, republican, municipal, and private, although the word "private" was not used, but rather camouflaged by the less ideological "personal"). It also permitted foreign entities (states, international organizations, companies, and citizens) to own land in the

USSR, and provided a foundation for foreign investment in the USSR. Furthermore, Articles 33 and 34 provided for the protection of property rights and abrogated previous laws violating these rights.

Significantly, this new Law on Property addressed investment and related activity (see *New in the USSR Legislature*, 1990). As of January 1, 1990, the state guaranteed the rights of foreign investors (private, joint venture). Should subsequent laws violate the rights of foreign investors, such laws would not be enforced until two years later. Any losses to investors resulting from such legislation will be reimbursed by the government. Article 23 states that all investments, domestic or foreign, regardless of form of property and ownership, are subject to the regulations of the new law. The first reaction to this new legislation was an announcement by John Marshall, in charge of international operations of the U.S. 3M Corporation, that his corporation would establish a regional branch in the USSR (*Izvestia*, 1990a). The January 1, 1992, decrees were aimed at motivating the formation of both local and foreign businesses in the different states of the Commonwealth.

Currency. The 1991 Law on Currency Regulation, reflecting a move against the dollarization of the Soviet economy, declared the ruble the only legal means of payment in the USSR. All transactions involving foreign currency in the Soviet Union are therefore subject to strict and rigid regulation by Gosbank (the state bank). At the same time, the law guarantees the right of any entity to possess, store, and operate with foreign currency. The law also requires the sale of a portion of foreign currency to the state. It defined the responsibilities of Gosbank regarding licensing, credit regulation, external debt regulation, and its relations to other banks. Finally, a Union-Republican Currency Committee was created to distribute and operate with foreign currency reserves. By January 1992, some of the independent states, such as Ukraine, had declared their intentions to issue their own currencies. Should these materialize, an important unifying factor will disappear from the Commonwealth.

Taxation. Under the old semifeudal system, every enterprise and citizen paid the state "as much as necessary." Responding to the need for a relevant system of taxation, an income tax law, applicable to foreign as well as Soviet citizens, was adopted and put into effect on July 1, 1990 (see *Commersant*, 1990). The law defines taxable and nontaxable sources of income, allowable deductions and tax credits, procedures for tax calculation, and tax payment. The new tax legislation, adopted by the Supreme Soviet in May, 1990, is centered in and administered by the Ministry of Finance and its regional branches.

On June 14, 1990, the Supreme Soviet adopted a Law on Taxation of Enterprises, Associations, and other Organizations, imposing taxes on profit, sales, export and import, wage surplus, and on non-operating profit (see *Regulation on Foreign Economic Activity*, 1989). In 1990, the tax rate on profits was 45%, with 22% going to the state and 23% to local authorities. In 1991, the tax rate on profits went down to 35%.

The new tax system began to develop, with many problems remaining to be worked out, such as difficulties related to accounting principles (depreciation, wages, etc.). Problems of accounting are almost as severe as the problem of convertibility of the ruble. Export and import taxation is a very painful issue for Soviet businessmen, since the rates are not established by law but are subject to changing government regulations. A 1991 presidential decree requires all Soviet enterprises (excluding foreign companies and joint ventures) to exchange 40% of their hard currency revenue into rubles at a fixed rate, which is tantamount to an additional tax on all export operations.

Other tax rates are also unstable, causing additional stress in the uneasy lives of Soviet managers. On October 4, 1990, President Gorbachev issued a decree: On Urgent Measures of Transition to the Market Economy, stating that in 1991 all enterprises must pay an additional 26% tax on wages paid, and must return 100% of any "extra profit" above a government-set limit, which varies in different sectors of the economy. Profitability, however, is calculated neither as return on investment nor as return on owners' equity, but as a ratio of profit to volume of sales. The preset limit is somewhere around 30–40%.

Foreign Economic Relations. In the area of foreign trade, all regulation has been provided by government decrees, the first of which was issued on August 19, 1986 (see *Regulation on Foreign Economic Activity*, 1989). This order granted all ministries and several hundred enterprises the right to engage independently in export–import activity, a major breach in the almost 60-year long monopoly of Minvneshtorg, the Ministry of Foreign Trade. This order gave certain chosen ministries and enterprises an opportunity to form their own export–import agencies and to have accounts in foreign currency in the Vnesheconombank (Bank for Foreign Trade).

At the beginning of 1989, procedures were established for registering and licensing enterprises engaged in export–import operations. Effective April 1, 1991, every Soviet enterprise (state-owned, individual, or cooperative) could operate legally in the international market. However, since the date of enactment of this legislation, changes have occurred which make this right more apparent than real. In reality, it is extremely difficult to get an export license for any commodity, even chopsticks for Chinese restaurants. Especially discouraging to export-oriented enterprises is the previously mentioned decree, requiring the sale of 40% of hard currency to the Vnesheconombank at a fixed rate of one ruble = $1.80. Moreover, export taxes are high; e.g., natural gas, 80%; machinery and radioelectronics, 30% (see *Economica i Zhizn*, 1991). By 1992, all enterprises and cooperatives were allowed to import and export freely, and newly established foreign firms were allowed to take their profits in hard currencies.

The Financial System. The financial system is both a challenge and a requirement for a market economy. Yet, most existing legislation is obsolete and unsuitable for a market economy.

Enormous state deficits are met by issuing more paper rubles, resulting in higher inflation rates. The former Minister of Finance, Zverev, wrote in his memoirs: "When I received orders to issue more money to cover the state needs, I had to obey. Such moments were not easy for me" (Zverev, 1977). The result is, and has been, the emergence of substitutes for rubles. People and organizations try to deal in dollars, pounds, or some other hard foreign currency, and if such currencies are not available, through barter. The first legislation to reform the financial system was the Law on Banks and Banking Activity enacted on December 11, 1990 (see *Izvestia*, 1990b). This law established a central banking system similar to the Federal Reserve System of the United States. The system consists of the central banks of the republics headed by the Gosbank, the central bank of the USSR.

The Gosbank has the same rights and responsibilities as those of a central bank in a market economy. It has the exclusive right to issue federal currency, license commercial banks and other banking institutions, and establish and oversee regulations regarding all banking operations. For the first time in Soviet history, the Gosbank is independent of the government. The formation of 11 independent Commonwealth states may lead each of these states to establish its own central bank and related financial policies and currencies.

BUILDING BLOCKS OF THE TRANSFORMATION OF THE SOVIET ECONOMY

Within the legal and managerial framework discussed in the previous section, several building blocks in the transformation of the Soviet economy have emerged. These include: consolidation of giant companies and refocusing enterprises; forming new associations; and developing cooperatives and small enterprises, leased enterprises, and joint ventures. *While these are discussed below, President Yeltsin's decrees of January 1, 1992, are speeding up the process by which these building blocks can form a sound market economy.*

Consolidating the Giants

Soviet industry is famous for its enormous enterprises in heavy machinery, chemicals and petrochemicals, aerospace, shipbuilding, and defense industries. These huge enterprises form the backbone of the economy, "the bigger the better," an idea supported for decades by those in charge. Now the giants are being split up into more manageable units.

One of the giants of the Soviet heavy electrotechnical industry, Sverdlovsk Production Association, "Uralelectrotyazhmash," was set up as an association in 1972 after a forced merger of nine independent electrotechnical plants, research labs, and an R&D department. The association appeared to be a highly diversified company serving various kinds of customers. Despite significant savings in administrative expenses, the operating expenses after the merger did not decrease, but rather increased. Even though, before 1987, no one was concerned about financial losses, as soon as the performance of a company started to be measured by its profit or loss rather than by the power of its bosses, the management of the association decided to restructure it.

As a result, the association shrank to two plants, one laboratory, and one R&D department. The "plant within a plant" concept was implemented by establishing divisions or profit centers, each focusing on its own narrow segment of the market. Another impressive outcome was a 46% reduction in the number of employees, from roughly 15,000 to fewer than 8000, which increased the plant's efficiency and effectiveness. This process of consolidation has been gaining momentum. During 1989, the number of state-owned enterprises decreased from 46,384 to 45,895 (*Narodnoye Khozyaystvo*, 1990). By 1991, an even greater number of consolidations took place. Yeltsin's New Year's decree encouraging Russian enterprises to become joint-stock companies will further stimulate such action.

Refocusing Enterprises

The collapse of the ministry system made it possible, and often necessary, for state enterprises to chart their own futures. Enterprise managers needed to decide whether to continue operations in the market assigned by central planning or to cater to other markets. For some enterprises in the defense sector, the decision was, and still is, a question of life or death. Because of the decrease in military orders, Znamya Truda, a plant famous for its Mikoyan Gurevich fighter plane, popularly known as MIG-29, made an unbelievable change: it contracted with its competitor to assemble Ilyushin-114 medium-range passenger jets. "If you want to survive, you have to make extraordinary moves," say Mikoyan executives.

More and more enterprises in the defense sector, especially since the aborted coup, have been trying to find their appropriate places in the emerging markets. It is not a smooth process. As might be expected, not all general managers of such enterprises really want to work in an open-market environment. This became evident as far back as December 1990, when directors of major industrial enterprises met with President Gorbachev and the then Prime Minister Ryzhkov. Tizyakov, at the time president of the association of state-owned industrial enterprises, as well as some other directors of defense sector enterprises, demanded the restoration of the rigid old centralized system. Under the old regime, defense enterprises were treated as elite, and had no problems selling their production.

The directors also demanded the restoration of the law prohibiting the resignation of qualified workers from defense enterprises. Fortunately, the majority of the leaders of the industry had enough common sense to reject these proposals, but the attempt itself was indicative of the bureaucracy's attitude toward a market economy. Tizyakov, unsatisfied, became one of the architects of the 1991 aborted coup. By January 1992, Yeltsin's decrees were promoting an even greater focus on consumer goods industries.

Forming New Associations

The industry of the USSR was organized on the basis of the so-called "branch principle," according to which the economy as a whole was the axis around which and for which everything revolved. Enterprises belonging to a particular branch or sector were sequentially grouped, with their related associations, from source to finished product. In the food industry, farming was distinguished from food processing, food processing from food packaging, and so on. The management of the associations of an industry was centralized in a particular ministry.

The breakdown of the ministry system provided an opportunity for managers of enterprises to seek better horizontal and vertical technological and managerial configurations for their businesses. This search resulted in the formation of new associations and infrastructures which are better tailored to meet customer needs. Examples include intermediate wholesaling agencies, information service bureaus, and specialized and commercial banks.

One example is the association in St. Petersburg (formerly Leningrad) known as the Energomash. Several well-known giants of St. Petersburg heavy industry, attached to five different ministries, formed a new association, without the assistance or permission of their ministries, in order to make a complete technological chain for the production of power plant equipment. Now the association produces turbines (Electrosila Plant), generators (Izhora plant), boilers (Leningrad Metal Plant), and monitoring equipment (Leningrad Electropribor Labs). The association plans to form an auxiliary service association from five of its enterprises to service Energomash customers, and eventually to service all power stations in the northwest region of the USSR.

Another example of integration is that of the Paton Welding Institute, one of the best-known research laboratories in the USSR. It was transformed into a company or association of enterprises engaged in research, design, and production of sophisticated welding equipment. It has organized its own export–import marketing for the whole company. The Institute is illustrative of the increasing number of horizontally and vertically integrated organizations coming into existence in the USSR.

During 1989–1990, after the adoption of the Recommendations for the Organization of Voluntary Associations by the Government Commission for Economic Reform, 49 concerns, 644 associations, 45 consortia, and 27 intersectoral state associations (MGOs) were formed.

Table 2. Associations and Their Characteristics

Type of Association	Degree of Centralization of Functions	Right to Join Other Associations	Period of Existence	Subordinate to Ministry
Concern and MGOs*	High, various functions	Limited	Unlimited	No
Association	Limited centralization of mutually agreed functions	Unlimited	Unlimited	Yes
Consortium	Centralized management of mutual funds	Unlimited	Limited to project period	Yes
Intersectoral technology complex (MNTK)	Coordination of development	Unlimited	Temporary	Yes

*Intersectoral state associations

The number of new organizations reached 765, combining a total of more than 10,000 enterprises. At the end of 1990, these "liberated" enterprises and MGOs had a turnover of 25 billion rubles and employed about one million people. According to the forecast of the Institute of Economics of the USSR Academy of Sciences, by 1993, these industrial associations will include 35–40% of the Soviet industrial potential (USSR Academy of Sciences, 1990). Table 2 provides additional information on the different types of associations and their characters.

The newest organizational form in the Soviet economy, and perhaps the closest to the Western corporate form of organization, is the stockholding association. In such associations, property is distributed among the owners on the basis of common shares owned by each shareholder. Though there were only 216 such stockholding associations in the USSR in 1990, their number may increase rapidly as a result of promotion by Yeltsin's January 1992 decrees.

Developing Cooperatives

Following the adoption of the Law on Cooperation, despite many difficulties, the cooperative movement developed very rapidly. As of July 1, 1990, a total of 268,603 cooperatives were registered, of which 209,659 were in operation. Even more impressive is the increase of the sales volume of the cooperatives; in three years, their annual sales increased 84 times, from about 300 million to 27 billion rubles, and accounted for 6% of the gross national product. Cooperatives employed 5.2 million people. Table 3 presents more detailed data on cooperatives.

The growth of the cooperatives is important not only because it relies on the principle of free enterprise, but also because of its impact on the business environment as a whole. Speaking to a large group of Soviet state managers at the Moscow Academy of the Na-

Table 3. Dynamics of the Cooperative Sector 1987–1990 (1991 Figures are Unavailable)

	1988 (April)	1988 (July)	1989 (April)	1990 (July)
Number of cooperatives registered				268,603
Number of cooperatives operating	19,539	77,548	99,347	209,659
Number of employees (per 1000)	245.7	1396.5	1950.8	5,220
Volume of sales (million rubles)	325.7	4307.2	6060.8	27,268
Taxes paid (million rubles)	—	—	—	4,020

Sources: *Narodnoye Knozyaystvo USSR*, 1987, 1988 (People's Economy of the USSR in 1987, 1988). Moscow: Statisticka Publishing, 1990; *Narodnoye Knozyaystvo USSR, 1990*. Moscow: Statisticka Publishing, 1990; Indexes of cooperatives' operations in the first half of 1990. USSR: Goscomstat tional Economy, Leonid Abalkin, Deputy Prime Minister in charge of economic reform, pointed out to his audience that their increased freedom of activity was in large part owing to the example provided by the "unfair competition" of the cooperatives.

In the early stages of cooperatives, government bureaucrats tried to control their growth, using traditional means of discrimination in favor of state enterprise in the areas of pricing, taxation, and sources of supply. Cooperatives responded by forming their own professional associations. The failed coup asserted the importance of the cooperative movement to the development of a market economy. The contribution of the cooperatives to the economic well-being of the Soviet Union will continue to grow. It is expected that most cooperatives will become private companies under the Decree on Small Enterprises, as well as under Yeltsin's decrees of January 1, 1992.

Small Enterprises

On August 8, 1990, the Council of Ministers issued a document called Measures for the Establishment and Development of Enterprise, extending the provisions of an earlier decree called Frameworks of a State-Owned Small Enterprise, issued by the Commission on Economic Reform.

Together these decrees opened the way to establishing a completely new type of business ownership for small enterprises. "Small" is defined in terms of number of employees and sector of the economy. For example, in industry a small enterprise is one which employs up to 200 employees; in research and development, up to 25; and, in service or retail trade, up to 15. The decrees allowed a business to be owned by the state, a family, or a group of people. The significance of this legislation was the *de facto* recognition of the principle of private property and private enterprise and the obligation of the state to protect and support these enterprises.

Though reliable statistical data about small enterprises is scarce, the most conservative estimates indicate that there are now several thousand small enterprises in the USSR. Furthermore, the trend to start small enterprises picked up additional momentum after August 1991 (Sementsov, 1992). Small businesses are supported by their own Association of Small Enterprises and by an International Center of Small Business. On January 1, 1992, Yeltsin further encouraged the privatization of small enterprises.

Leased Enterprises (*Arenda*)

On November 23, 1989, the Supreme Soviet adopted the Basics of the Legislation of the USSR on Arenda, which provided the framework

Table 4. *Arenda* (leased) Enterprises 1989–1990 (1991 Figures Are Unavailable)

	Number of Enterprises		Sales (Bill. Rbls.)	Share of Sector (%)
	1989	1990		
Industrial enterprises	1332	2100	31.0	4.6
Construction enterprises	731	800	2.7	3.6
Retail trade, restaurants	—	1000	36.1	10.6
Service enterprises	138	1700	0.5	7.3
Total	2201	5600		

Sources: *The Process of Formation of Organizations With Different Types of Ownership.* Report of the Institute of Economics, USSR Academy of Science, 1990; *Narodnoye Knozyaystvo USSR, 1990.* Moscow: Statisticka Publishing.

for transforming state property into collective or private property. This measure was designed to encourage the establishment of enterprises engaged in international trade by providing an intermediate stage for transforming, as it were, a state-owned enterprise into a private international company by means of a rental or lease contract.

At the beginning, since many enterprise managers and employees adopted a wait-and-see attitude, the formation of *arenda* enterprises was relatively slow: only 800 during 1990 (*Narodnoye Khozyaystvo,* 1990). However, the formation of arenda enterprises probably will increase, especially since the aborted coup.

Arenda enterprises will become corporations (enterprises owned by stockholders) or will be bought out by their employees and become private businesses. And, due to the fact that the *arendas* operate in the international market, they will help move the whole economic system toward a higher degree of market orientation. For more details, see Table 4.

Joint Ventures

Until 1990 direct foreign investments in the Soviet Union was prohibited by law. As a result, the joint venture (JV) became a way for foreign companies to enter the Soviet market and for Soviet enterprise to participate in the world market. From 1988–1990, 2100 joint ventures were registered, of which 400 were in operation by 1991. In 1989, the sales volume of JVs was 600 million rubles (*Narodnoye Khozyaystvo,* 1990). By mid-1991, the number of JVs increased to 3400, they employed 117,000 people (115,000 were Soviet citizens), and the total sales volume of the JVs reached 2.3 billion rubles. Some of these JVs became well known, such as the Soviet–German Lenwest and Belwest (footwear) and the Soviet–British Femtek (hygienic tampons). The Femtek plant in Kiev is the second largest producer of tampons in the world.

However, investment in JVs has been steadily declining; in 1990, the total investment in JVs decreased from $1.360 billion to $850 million (*Narodnoye Khozyaystvo*, 1990). In addition, since 1987, 300 JVs have withdrawn their registrations without initiating operations. Of 124 U.S. JVs established in 1990, only 10% are in manufacturing.

Factors affecting this decline and disenchantment are rooted in the legislation which makes direct foreign investment in the USSR possible and provides better guarantees as well as in more positive state and local bureaucracies, and in difficulties related to the lack of hard currency, new taxes, and unrest in the Soviet Union. The failed coup, the secession of the Baltic Republics, the formation of the Commonwealth, and the general state of confusion brought the establishment of new JVs almost completely to a halt.

CONCLUSIONS AND IMPLICATIONS

Amid the confusion and uncertainty, the economies of the Commonwealth of Independent States are being transformed into market systems, which are capitalizing on the collapse of the Union and the various ministries and on the developing building blocks of the former Soviet economy. Managers are being trained under free market conditions and new legislation and decrees are providing the legal foundations necessary for the operation of a free market. At the same time, the building blocks of the new economy, namely, consolidating and refocusing existing enterprises; forming new associations; and developing cooperatives and small enterprises, leased enterprises, and joint ventures, are developing rapidly. This move toward a market economy, which may confront many obstacles and take more than a decade to become established, will continue to develop, regardless of the specific nature of the association among the eleven states of the Commonwealth. This is because the idea of a fully planned economy is no longer acceptable to the members of the Commonwealth.

Confusion and uncertainty notwithstanding, the Soviet Union has an enormous unrealized potential, both as a producer and as a consumer, a fact which executives of global companies cannot afford to ignore.

As a producer, the Soviet Union is rich in natural resources. Realizing the potential of these resources will be beneficial to both the Soviet Union and to global companies. These resources have been concentrated in heavy industry oriented to defense, the production of weapons and related space exploration and research. In those areas, Soviet knowledge, skills, and technology are equal to those of the most developed nations. In the international weapons market the Soviet Union competes with the West. Under free-market conditions this capability can be competitive in world industrial markets, such as aerospace, shipbuilding, radioelectronics, and telecommunications. However, this will become possible only through collaboration with Western companies possessing complementary skills and technologies.

Examples of such profitable partnership are provided by the Sverdlovsk Transportation Machinery Plant and the Moscow Ilyushin Plant. The Sverdlovsk Transportation Machinery Plant is building an advanced self-propelled heavy artillery system for Finland, and the Moscow Ilyushin Plant in the aerospace industry announced a vast program to produce and export a long-range widebody Ilyushin-96 jet. The plane will be equipped with Honeywell avionics and Pratt-Whitney engines.

As a consumer, the Soviet Union has more than 290 million people with pent-up demand for almost any product one can think of. However, due to high levels of uncertainty, global companies should begin with small steps in this market in order to reduce their risk while studying the market and building relationships. This should enable global companies to make future decisions based on first-hand information.

A case in point is the Toyota Company. In 1990, Toyota expected to sell 1500 cars in the USSR, and in 1991 it planned to sell 3000. Since 1989, Toyota has opened two offices, in Moscow and in Khabarovsk, as well as a service center, to be followed by additional centers (*Vechernyaya Moskva*, 1991). In an interview with Moscow's evening newspaper, *Vechernyaya Moskva*, Toyota's general representative to the USSR, Shatoshi Oky, said "What is gradually occurring in your country is familiar to the Japanese and becomes comfortable for us and our Soviet partners" (see *Vechernyaya Moskva*, 1991).

From this vantage point, strategic market entry considerations are especially important because of the limited information available about markets in the different states of the Commonwealth. While textbook procedures for market analysis may be helpful, their value in analyzing east European markets is often limited. This is because of lack of information; unreliability of available data; different definitions and methods of accounting, such as valuation and depreciation; and the different written and unwritten rules governing business. As a Western manager, whose company recently entered the

Russian market, revealed: "We learned an expensive lesson when we realized that here in Russia statistical data is often very 'soft,' and its business meaning quite different from what it is normally thought to be in the West."

In view of this, the following simple but crucial recommendations are made to global managers interested in opportunities presented by the Commonwealth of Independent States.

1. *Take a long-term perspective.* The transformation of the Soviet Union into the CIS is, and will continue to be, an evolving economic and political drama. Central themes in this drama include different degrees of economic and political liberalization developing at different rates in the various areas. Ethnicity and religion are significant influences. Taking a long-term perspective may improve management's assessment of long term opportunities in the region.
2. *Take small steps before running.* Since business practices in the CIS are often markedly different from those to which global companies are accustomed, low-scale initial involvement and investment in these states provide a global company and its managers a chance to study new opportunities while already operating on a small scale in those areas. Also, such a presence makes it possible to develop alliances. Toyota's entry into the Russian market is a good example of this strategy.
3. *Analyze each situation separately.* Though the states of the Commonwealth have many things in common, they are also dissimilar in many ways. As a result, they may represent different opportunities for global managers. Hence, use of different market entry strategies may be desirable in entering the different Commonwealth markets.
4. *Deal with entrepreneurs.* As changes toward a market economy continue, many Soviets, whether in private business or in public enterprises and the government bureaucracy, have developed an eager "can-do" attitude. Identifying and dealing with these professionals can not only be a time-saver, but can also help avoid initial mistakes.
5. *Capitalize on knowledgeable Westerners.* Knowledgeable Westerners, especially those who grew up in the Soviet Union but were educated and employed in the West, are well-suited to bridging cultural and business differences. This strategy has been used successfully by Femtek in Kiev.

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