

Ivan Tchalakov – 2003 IPF Fellow
Technology Studies Group - Institute of Sociology, Sofia

Innovative SME (neo-Schumpeterian entrepreneurs) in Bulgarian Economy: The Initial Environment and Sectoral Paths

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The IPF project aim ...

To explore the patterns of development and economic behavior of a specific cluster of Bulgarian enterprises - *the innovative private SME as potential bearers of 'technological renaissance' in the country* (Dyker 1997).

- ◆ Two sectors chosen – *Information & Communication Technologies* and *Perfumery & Cosmetics*

...and focus of present lecture

- ◆ The economic and social context in early 1990s Bulgaria, in which the innovative private SME emerged.
- ◆ *Main thesis*: The emergence and development of this type of SME is *sector-specific*, related both to the *late-socialist legacy* and *political and economic dynamics during the 1990s*
- ◆ *Approach*: Integration of ideas from *evolutionary approach* in studying technical change (J. Schumpeter, Chr. Freeman, G.Dosi, P.Murrell); the *industrial upgrading* (Gary Gereffi) and *sectoral approaches* (M.Shafer) developed in the studying of industrial transformation in Latin America and East Asia; *path dependency* (D. Stark and L.Bruszt) and *socio-technical networks* (M. Callon) approaches and some recent findings of *historical sociology of socialism* (Ivo Mojni, I. Szeleny, A. Boundjoulov).

Structure of the lecture

- ◆ The Bulgarian economics before 1989 (basic features):
 - The socialism from the point of view of innovation (Joseph Schumpeter on economic development in non-market economy).
 - The two points Schumpeter neglected:
 - sources of innovation are not given
 - nomenclature is not homogeneous
 - The clash between economic and party nomenclature in mid 1980s as formative for the developments in 1990
 - The “thickness” of the economy – rent-seeking capitalism *versus* innovative entrepreneurship in different economic sectors

The economic activities in Bulgaria before 1989

- ◆ *One of the lowest shares of private property among CEU countries - 100 % in agriculture; almost 100 % in industry and services*
 - Economy dominated by large vertically integrated *State Economic Combines* – internal specialization along technological chain, in house R&D facilities;
 - Foreign trade in the hand of *Foreign Trade Combines* separate from the industrial ones;
 - Only three commercial banks by 1988, subordinated to *Bulgarian National Bank*

The economic activities in Bulgaria before 1989 (2)

- ◆ *The nomenclature* - one of the most powerful among CEU countries
 - Communist Party committees in every economic, educational, cultural, military, etc. institution;
 - Total control over the management in each field ('cadres') by Party's organizational departments;
 - No dissident movement till 1988;
 - Tightened political control after 1984 (changes in the names of Bulgarian Turks);
 - Yet 'soft' regime, 'buying' opponents instead of punishing them;

The economic activities in Bulgaria before 1989 (3)

- ◆ Small and discontinuous steps in relaxing central control in the economy since early 1980s
 - Some industrial combines was given right to foreign trade activities;
 - Bulgarian joint ventures emerged in some Western countries (Austria, France, UK, USA);
 - Limited private activity allowed in agriculture (so called ‘personal farms’ with up to 0.4 ha land);
 - In 1987 the Government Decree No. 56 allowed private firms in industry and trade. Less than 200 small private firm (mostly in trade) till 1990.
- => *The vast majority of economic agent have no experience and no access to resources for entrepreneurial activity*

J. Schumpeter on economic development in communism

◆ The critique of neoclassical and Marxist vision of capitalism

Distinction between *circular flow* and *development* - in the first the economic system function in a "static" state, as a "routine" following the beaten track of "past cycles".

The **development** signifies a specific class of economic changes - the radical, abrupt changes in production.

J. Schumpeter on economic development in communism (2)

The fundamental impulse, which puts the capitalist machine in motion is printed onto the level of consumer goods, the new methods of production and transport, new markets, new forms of industrial organisation, i.e. all those components born by the capitalist initiative.

*... key aspect of "economic development" is the **competitive elimination** of the old forms of production. This process of "creative destruction" is fundamental trait of capitalism.*

J. Schumpeter on economic development in communism (3)

- ◆ The introduction of innovations is impossible without the *function of the entrepreneur*. The only contribution of entrepreneurs is their *will* and *action* in channelling the existing production resources along new tracks.
- ◆ The access to capital (credit) is critical condition for the introduction of innovations. Providing access to credit for every potential entrepreneur is key condition for economic development (*economic democracy*).

J. Schumpeter on economic development in communism (4)

◆ From the point of view of innovations

"*capitalist*" economy is the one in which resources needed for new production are drawn from the circular flow by an *ad hoc* established purchasing power (bank loan), while

"*communist*" economy is an economic form where the resources necessary for new production are drawn through *some kind of power or command*.

"Leaders" (nomenclature) in communist economy can play the role of entrepreneurs *directly*, without using bankers as middlemen.

J. Schumpeter on economic development in communism (5)

◆ Three main consequences for socialist economy:

Entrepreneurial activity of the nomenclature as third production factor

(as *means of production*, alongside labour and natural resources (the land)).

Disappearance of the effect of “creative destruction”

The nomenclature’s direct control over resources does away with competition (bankers and other entrepreneurs). *This abolishes barriers to innovations, but it also remove the pressure on sectors working with old technology.*

Narrowing of the social basis of entrepreneurship

The absolute control of communist leaders over resources *deprives the remaining economic agents of the possibility to carry out independent entrepreneurial activities.* This has negative long-term effects on the rates of innovations in communist economy.

Two critical remarks on Schumpeter's model:

- ◆ ***Source of innovation - invention, discovery - taken for granted.***

This ignores major aspects of the relation between discovery and invention - the problem that has become especially acute since the early 20th century with the rise of "science-based" industries

- ◆ ***The nomenclature is not homogeneous group!***

It is split in different camps not only vertically, but also horizontally.

=> The speed and direction of economic development depends in a crucial manner from the internal straggle and constellation of forces between these different camps.

Historical sociology of socialism on the nomenclature

“... Lenin was aware of the importance of the apparatus. However, he chose to strengthen the state apparatus because he needed its support to perform as head of the government while Stalin relied on the party apparatus....”

Stalin introduced strict control over the state apparatus (which executed primarily economic functions) through newly fledged party structures.

*The party apparatus had to control all other apparatuses in the country, including the economic one, and above all the one in industry because it had the most independent, educated and pre-eminent cadres.” (A. Ribakov, *The Children of Arbat*, 1987: 250-251; 266)*

Historical sociology of socialism on the nomenclature

- ◆ The nomenclature is formed of different circles having privilege access to different recourses - economic, ideological, organizational, informational, etc. Their relative *weight is determined by the access to the political capital* (P. Bourdieu).
- ◆ The main battle is between the *party* nomenclature (the organizational department, those responsible for the ‘cadres’, and ideological one) and *economic* (technocratic) nomenclature. The first is the keeper of the doctrinal project, the other is the potential mouthpiece of quasi-capital motivations.

The stake is the emancipation of the economic nomenclature. (*Boundjoulov, 2003*)

Historical sociology of socialism on the nomenclature

- ◆ It was not the whole “apparatus” but only part of it – *the economic and most of all industrial nomenclature of “independent and highly accomplished grandes”, which was able to carry out reforms (innovations) in the economy.*
- ◆ This distinction rents the administrative hierarchy end to end and on all levels! This is different from Kornai, to whom the differences within the nomenclature are between the lower (local) and the higher (central) level).

The missing link – innovations in late capitalist economies

- ◆ *The communism was established in relatively less developed societies, so in the beginning they need only to copy the innovations that win in the developed countries. (electrification!). The nomenclature found themselves in the unique situation of having to combine characteristics and functions of both "first movers", i.e. the entrepreneurs revolutionizing the industry, and "second-line movers" - who were saved the risks of the first phases of innovation.*

Compared to the market economy, the advantages of administrative coordination were manifested - lack of competition on the credit market, removing threat of imitation, appropriation of the entire entrepreneurial profit.

None of the entrepreneurs in market economy could have dream of such a power.

Three phases of development in socialism:

- ◆ 1) *Building preconditions of development* – establishment of national science and technology infrastructure; large scale education; suppressing the autonomous economic agents (nationalizations of the industry and financial system)
- ◆ 2) *Accelerated growth* (Kornaj) – launching the large industrialisation by massive copying Western technology.
- ◆ 3) *Deceleration of growth* - approaching the economic level of developed capitalist countries. Exhaustion of the regime of development based on ‘reverse engineering’ and scientific & technological intelligence. The needs of indigenous innovations

Tensions inside nomenclature

- ◆ According to Shumpeter the “party nomenclature” (organizational and ideological departments) is completely useless for economic development. However, historical sociology of socialism has found, that ‘socialist entrepreneurs’ have been restricted too!
- ◆ Just like capitalist entrepreneurs have been restricted by bankers, the socialist technocrats are controlled by party nomenclature:
 - To “follow the rules” and not to appropriate the profit for themselves;
 - To punish unsuccessful innovations (sabotages).

Tensions inside nomenclature

- ◆ During the initial phase of socialist development the economic nomenclature needed the party one to provide some of the resources for introduction of innovations (mass education, non-economic mobilization, discipline, etc.). At this stage of massive copying Western technology the failures have been relatively few.
- ◆ All this gradually changes with the exhaustion of the initial sources of growth and the need towards indigenous innovations.

The key battle in late socialist Bulgaria – in 1985-1987, and not in 1989

- ◆ Raising tensions between economic (industrial) and organizational-ideological-foreign trade nomenclature. The victory of “rent-seeking” & assets stripping against “entrepreneurial” nomenclature.
- ◆ Suppression of the economic nomenclature from its political and economic positions in late 1980s and early 1990s
- ◆ Suppression of the newly emerging autonomous local economic agents and foreign capital till 1996

The “thickness” of economy – rent-seeking capitalism *versus* entrepreneurship in different economic sectors

- ◆ The “second networks” – multitudes of resources in society and different degree of permeability of the ‘rent-seeking’ capitalism.
- ◆ Emergence of niches of authentic entrepreneurial behavior in 1990s. Information technologies and Perfumery & Cosmetics as an example.