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INSTITUTIONS AND REGIONAL DEVELOPMENT: EVIDENCE FROM HUNGARY AND UKRAINE

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Regional Inequality in an Enlarged Europe: Regional Performance and Policy Responses

On 12–13 March 1998 the Centre on European Political Economy at Sussex organised a research workshop to examine the regional dimensions of change in an enlarged Europe. The workshop brought together some 40 academics, practitioners and post-graduate students and was organised as part of the inaugural activities of Sussex European Institute's new Centre on European Political Economy. The workshop, which was supported financially by the University Association for Contemporary European Studies and the Economic Geography Research Group of the Royal Geographical Society (with the Institute of British Geographers), examined what the enlargement of the European Union to East-Central Europe will mean for the changing map of regional inequality in Europe. During the workshop three main themes were addressed:

- the level of regional inequality between the member states of the EU and the potential new members,
- the degree to which the relative performance of institutions matters in accounting for levels of inequality between regions, and
- the potential policy responses to regional inequality in a much larger Europe.

Four main papers, of which this is one, were presented and discussed during the workshop, and are published as Centre on European Political Economy/Sussex European Institute working papers. The papers were all edited by Adrian Smith, organiser of the workshop, and provide a record of some of the discussions held over the two days. For more details of the work the Centre is undertaking on European regional development please contact Adrian Smith (a.m.smith@sussex.ac.uk).

INSTITUTIONS AND REGIONAL DEVELOPMENT:EVIDENCE FROM HUNGARY AND UKRAINE

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Introduction[1]

This paper interrogates the dynamic that exists between the imposition of performance standards in order to maintain economic efficiency and the scope for experimentation through which performance standards are enhanced, a dynamic which is central to institutional and evolutionary approaches which seek to explain processes of economic transformation in eastern Europe and beyond. Amin and Hausner (1997) have recently likened this dynamic to a process of "steering" or governing by which increasingly complex functionally-indistinct socio-economic systems undergo simplification or organisation, (see also Jessop 1997). Similarly, Stark (1997, 51) has also addressed the organisation of diversity and identified two types of mechanisms: those which permit experimentation in the presence of uncertainty and those which involve the justification or accountability of social action. Elsewhere Storper (1997) has argued that the balance between corporate strategies which seek cost advantages through efficiency gains (and the imposition of these gains on others) and those which seek cost advantage through experimentation is one of the most important dynamics driving economic development. In the context of theorizing 'industrial complexes' van Tulder and Ruigrok (1997, 134) have concentrated on the properties of inter-institutional relations between institutional actors as an explandum for the variations in the performance and processes of change of different institutional arrangements. Thus relations of independence or, at the other extreme, of structural control between institutions result in institutional frameworks which, respectively, are under or over cohesive and from which emerge barriers to sustaining performance. Thus as Grabher found in relation to the Ruhr (1993), intense inter-firm linkages coupled with a close relationship between leading industrial actors and regional political institutions can be a double edged sword switching rapidly from a dynamic growth model to form a fossilised barrier to restructuring. More generally the tension between imitation and unity, and deviation and diversity is reflected in the distinction between regional development strategies which seek to cultivate dissonance amongst regional relational resources (Grabher 1995) in much the same way as Storper (1995) has emphasised the role of "untraded interdependencies" (a process we may term adaptability) (Grabher 1997), and those which seek complementarities amongst economic actors across tangled hierarchies of more encompassing spatial scales (a process of adaptation) (Jessop 1997, 106).

In this paper I seek to point to the variety in the of institutional arrangements found in regions in eastern and central Europe (ECE) and the former Soviet Union (FSU) and understand the institutional processes which explain differences in the performance of regional economies. The paper examines two regional space-economies which have both undergone very different processes of selective (re)integration into the capitalist world economy. In the 1990s, Hungary attracted relatively high levels of direct foreign investment (DFI) which in the absence of effective institutional guidance produced a form of integration in which parts of

[1] The research reported in this paper is based on semi-structured interviews. In Hungary interviews were conducted with Magyar Suzuki managers and trade union officials representing workers at the plant (and its suppliers) as well as local and national government officials connected to local economic development in 1992, 1993 and 1997. In Ukraine interviews were conducted with officials from the Ministry for the Coal Industry, the World Bank and the ILO as well as local academics in 1997.

the space-economy became 'global outposts'. By contrast economic transition in eastern Ukraine was slow and 'involuted' in which foreign investment was notable by its absence with the result that international financial institutions working through the state became the agents seeking to impose integration with the world economy. Based on in-depth studies of the restructuring of the automotive industry in Hungary and the coal mining industry in eastern Ukraine, the paper argues that in both regions there was 'institutional failure' stemming from asymmetrical relations between institutions. In Hungary foreign investors were overly dominant at the expense of state and local institutions which resulted in a form of development which effectively excluded local producers from pan-European industrial networks. In eastern Ukraine entrenched local producers and allied institutions were too dominant at the expense of both the national-state and new/foreign institutions which generated barriers to industrial and regional restructuring. Despite different pre-existing conditions and inverse institutional processes in the two examples both forms of institutional failure involved a weak national-state and the absence and/or exclusion of particular types of institution.

The paper addresses three sets of claims about the relationship between institutions and regional development. First, that international firms, despite their mobility, continue to rely on selective (de)mobilisation of localised resources which explains variations in the 'embeddedness' of direct foreign investment in host regional economies (Dicken et al. 1994). Thus the mosaic of European regional economies comprises 'sticky' economies relatively wedded to place and grounded on local institutions and 'slippery' economies wedded to space and grounded in inter-territorial competition as regions seek to attract, pin down and embed hyper-mobile flows of capital (Markusen 1996). Second, it is claimed that 'institutional thickness' (Amin and Thrift 1994, for a critique see Hudson 1994) within a regional economy can if not fix then manage and contain regional inequalities generated by capitalism by stimulating dynamic regional development based on inter-institutional learning (Morgan 1997). Third, it is claimed that there exists an important interplay between and co-evolution of processes of industrial restructuring and processes of national and local state restructuring (Swyngedouw 1997).

Institutions and regional development in eastern Europe

Smith and Swain (1998) have suggested that peripheral regional economies in eastern Europe are marginalised through either their exclusion from international production systems owing to 'disembedded' forms of direct foreign investment (Grabher 1994b) or are 'overembedded' in pre-existing industrial networks which forsake mechanisms for on-going dynamic or reflexive adaptability for simple one-off adaptation to new socio-economic conditions. Grabher and Stark (1997) deploy evolutionary metaphors to identify the tension that exists between mechanisms of accountability which involve some form of selection process between different forms of collective action and which permit on-going dynamic adaptability and mechanisms which preserve a genetic pool of institutional types including currently redundant ones from which future forms of collective action in response to a changed environment may emerge. Thus they emphasise the need to preserve ambiguity over the preferred form of economic behaviour at any given point in time whilst imposing accountability in order to maintain 'sub-optimal' behaviour within acceptable limits. They argue that as localities are sites of institutional interaction and friction, it is at the regional scale that the variety in organisational forms should be protected. Elsewhere, Grabher (1994a) has elaborated this argument further by suggesting that 'redundancy' within both corporate networks (for example in the form of research and development functions) and

regions (such as technical advisory agencies) are necessary for the future adaptation of regional economies. Similarly, in the context of the development of de-centred corporate networks in Hungary, Stark (1996, 143-6; see also 1997) has suggested that ambiguity in economic systems, specifically over property relations, can be a source of innovative economic action as agents seek to hedge in response to uncertainty.

In addition to challenging the desirability of imposing overly stringent performance standards on economic agents, a number of researchers have pointed to the *de facto* difficulty in imposing them in transforming economies and to the limited detrimental effect such difficulties have posed. Thus, Sabel and Prokop (1996, 159) found significant industrial restructuring in Russian regions despite the absence of effective 'market signals' which led them to question the importance of traditional background or 'backstop' governance in explaining processes of economic adaptation. Moreover, based on a study of the impact of privatisation on industrial restructuring in central Europe, Chavance and Magnin (1997) suggest that as control rights over property remained diffuse external governance of managers has not been the prime mechanism of change. Instead from pseudo privatisation emerged multiple and interwoven forms of governance - hierarchy, market, and networks. However, as opaque lines of responsibility reduced the performance discipline to which enterprise managers were exposed, they suggest that such mechanisms could result in a process of 'lock-in' and poor performance.

Burawoy (1996, 1109) has identified the dangers posed by the absence of effective governance mechanisms. He contrasts processes of creative destruction through which capital is accumulated with 'preservation-destruction' in which there is a process of 'involution', a "profound economic degeneration in which an economy feeds upon itself". He describes the situation in Russia in which "the failure of the Russian state to organise the market economy has led to a co-ordination and entrepreneurial vacuum into which have stepped conglomerates, banks, mafia, siphoning off surplus from production to exchange" (Burawoy 1996, 1114). Moreover, according to Burawoy, the vacuum is explained by the spatial logic embodied in the organisation of relations between central and local state institutions in which neither regions nor enterprises are subjected to market or non-market determined performance standards. Grabher (1992, 1994b, 1995, 1997) has identified the problems posed by an altogether different type of vacuum emanating from a lack of interaction between foreign investors and the local economy. In doing so he characterises early manufacturing investments in east Germany as 'cathedrals-in-the-desert' which had few links to the local economy and which thus contributed to a form of 'truncated industrialisation'. However, others have argued that in a few cases, especially where foreign investors' have sought to utilise pre-existing industrial networks and atmospheres, DFI has become relatively embedded in the local economy and contributed to regional development (Pavlinek and Smith 1998).

One feature of the emergence of different institutional constellations in eastern Europe has been the variation in the strength or weakness of national states. Thus, it became clear that economic transition involved not so much a withdrawal of the state as a process of 'filling-in' and re-engaging the national state with the economy (cf. Voszka 1995). Moreover, due to the fiscal crisis they faced and the absence of the institutional capacities needed to manage their finances, national-states within eastern Europe remained weak as they attempted to construct and dismantle state institutions (Campbell 1995a and b). As a result not only did the state remain a significant economic actor, even after privatisation, but state institutions continued

to operate in an ad hoc manner responding to crises rather in a statutory mode (Martinsen 1995).

As a result of the weakness of national-state institutions as well as civic institutions more generally, attention has been paid to the construction of institutions and agents to adopt industrial restructuring and economic development goals at the regional scale (Jessop 1995). Thus, Surazska et al (1997) have identified the emergence of territorial cleavages and have argued for the introduction of a regional tier of local government. Hausner et al (1997) suggest, following their study of economic buoyancy in several localities in south-east Poland, that regional-scale institutions (such as regional development agencies, local financial institutions and educational establishments) and the properties of policy networks play a major role in encouraging regional development. In particular, they emphasise the need for institutionalised negotiation between social interests at the regional scale owing to the problems posed by the institutional paucity bequeathed by state socialism and the scale of industrial restructuring necessary (pp.191-2). In a similar vane, Kosonen (1997) argues that economic development problems faced by the Russian town of Vyborg are explained by the lack of local institutions and externally orientated networks. In particular, she advocates an associationist model of development not dissimilar from flexibly specialised small firms locally embedded but outwardly orientated. However, Smith (1997) has questioned the usefulness of such an approach having discovered that those SMEs that have been formed in Slovakia differ in important respects from industrial districts in western Europe; not least in the way SMEs tended to be involved in trading rather than productive activities. Elsewhere, van Zon (1992) has argued for the establishment of regional systems of innovations to counter the decomposition of the scientific potential in eastern Europe

The remainder of the paper is divided into two parts. In the following section I concentrate on processes of institutional entanglement. In Hungary I show how Magyar Suzuki became entangled in the complex 'decentralised reorganisation' of state owned industry whereas in Ukraine a process of 'decentralised preservation' or 'institutional fission' resulted in the entangling of the coal industry. In section four I focus on processes of institutional disentanglement in which Magyar Suzuki sought to extricate itself from its web of connections by 'rescaling' its operations and how the World Bank sought and failed to introduce a process of 'negotiation' into the coal industry in Ukraine. These two examples are particularly useful in permitting an interrogating of the dynamic that exists between institutional change and economic performance through an examination of the relationships between: (1) diverse and interwoven mechanisms of governance and forms of enterprise integration, and (2) different constellations of institutions and mechanisms of governance and industrial restructuring.

'Decentralised reorganisation' and 'decentralised preservation' in Hungary and Ukraine: processes of entanglement

The restructuring of the Hungarian automotive industry: 'decentralised reorganisation' and the emergence of 'recombinets'

The major feature of the economic transition in Hungary was simultaneously large inflows of direct foreign investment (table 1) and the rapid decentralisation of the industrial economy (Neumann 1992, 1993). Thus, a high proportion of direct foreign investment involved either the construction of 'greenfield' factories or the complete acquisition of existing state owned firms and a relatively small portion of joint ventures (table 2). Consequently, DFI in Hungary tended to form 'cathedrals-in-the-desert', loosely connected to the domestic industrial economy. At the same time the domestic industrial economy was transformed through a process of 'decentralised re-organisation'. This involved, in the most extreme cases, state owned enterprises transforming themselves into empty holding companies having 'hived-off' production facilities to form 'satellites' companies which operated as if they were privately owned. Stark (1996, 1997) has suggested that this process involved the dissolution of the features of state and privately owned property to form what he has termed 'recombinant property'. Moreover, he has suggested that as the relations between holding companies and their satellites became entangled networks of recombinant property, what he terms 'recombinets', were formed. That is to say, networks of institutions which bridged public and private, domestic and foreign, and industrial and finance capital. However, Whitley at al (1995, 1996a, 1996b) found from their study of ten large industrial firms that the degree of autonomy permitted to 'satellite' enterprises varied from firm to firm and over time according to prevailing privatisation and industrial policies. Moreover, they also suggest that this form of development was marked by a high degree of continuity in firm operations and inter-firm relations.

The parallel establishment of new industrial capacity by foreign investors alongside but largely separate from the transformation of existing industrial capacity was equally apparent in the case of the automotive industry (Swain 1996). Thus, compared with Poland and the Czech Republic, where foreign investors acquired existing car makers, in Hungary foreign companies such as Suzuki, GM, Ford and VW preferred to establish 'greenfield' facilities (Sadler et al. 1993, Havas 1997). In the early 1990s 11 per cent of all inward investment was in the automotive sector (Sadler and Swain 1994) and by the end of 1996 automotive direct foreign investment in Hungary amounted to approximately 2.5bn USD and the creation or safeguarding of at least 20,000 workplaces (table 3). At the same time, the large traditional domestic auto firms struggled to adapt to the new economic conditions and the loss of traditional markets. Thus for example, the production of buses at IKARUS fell from 14,000 to 2,000 in the early 1990s and attempts to privatise a portion of the enterprise had still not succeeded by 1998.

One 'greenfield' auto investment, by the Suzuki Motor Corporation of Japan, in the town of Esztergom to the north of Budapest, which was intimately connected to the state, spanned the divide that existed between the Hungarian automotive industry and the automotive industry in Hungary. From the late 1970s onwards the Hungarian state had sought to attract a foreign automotive investor to provide the impetus for the modernisation of the state owned auto industry and establish domestic production of cars. The project was thus conceived as a *dirigiste* state-led project which was designed to impose industrial transformation from

above. In this way is resembled one of the state's Central Development Programmes (CDP) launched in the late 1960s from which the planned auto industry (linked to industries elsewhere in the CMEA) emerged. Negotiations between Suzuki and the government commenced in 1985 and culminated in the formation of a new joint venture company, Magyar Suzuki Rt., in which Suzuki Motor Corporation took a 40 per cent stake (table 5). The other major shareholder in the venture was Autokonzern, a holding company established by the Ministry of Industry designed to establish links between Suzuki and domestic engineering producers. Thus, Autokonzern was itself owned by a total of 62 state-owned enterprises which were either already involved in the Hungarian automotive sector or other engineering enterprises which sought to become so. In this way the Hungarian state sought to weave ownership relations and hoped-for supply relations as a means to encourage new patterns of inter-firm integration. Amongst the 62 enterprises were not only leading producers such as IKARUS itself and Mogurt, the sector's state owned monopoly trading company, but also a variety of engineering enterprises which produced components for either IKARUS or car assemblers in the Soviet Union, Yugoslavia, Romania and Poland. The remainder of the equity in the joint venture was owned by the Japanese finance house C. Itoh, later renamed Itochu, (11per cent) and International Finance Corporation (a subsidiary of the World Bank) (9 per cent).

The USD 235m investment involved the construction of a car assembly plant which comprised a panel stamping shop, a body assembly shop, painting and final assembly. In addition to Autokonzern's involvement, the state offered grants towards the cost of investment as well as a ten-year tax holiday and other tax concessions which gave Suzuki a 22 per cent customs preference over other vehicle importers. In sum, Suzuki Motor Corporation provided just 16.6 per cent of the joint venture's start-up capital (Kiss 1992). In this way the Suzuki project was, *de facto*, a major instrument of industrial policy. Thus, the Ministry of Industry and Trade (1991) expected local content to be 30 per cent, and that Suzuki would itself generate more than 18,000 jobs. Thus the emphasis placed on the development of the existing supplier base, which was a legacy of the initial conception of the project, and the fact that the state had an equity stake in the venture suggested that the project could have potentially far reaching industrial restructuring and regional development impacts. Added to this was that it was the only major auto-related investment involving a Japanese firm in the early 1990s and raised the prospect of the Japanisation of the Hungarian engineering industry.

Crucially, Autokonzern's 40 per cent stake in Magyar Suzuki's embedded the joint venture firmly within a 'recombinet', a complex which linked virtually all Hungarian automotive enterprises and many other conglomerate-type engineering enterprises besides (figure 1). The 'recombinet' was centred on IKARUS, the bus maker. Up until the late 1980s, IKARUS produced up to 14,000 buses and coaches per year mainly for the Soviet Union market accounting for 15 per cent of Hungary's rouble-denominated exports (Swain 1996). Moreover, besides employing 11,000 in assembly plants in Budapest and Szekesfehevar and in plants producing components elsewhere, IKARUS lay at the apex of a supply chain including more than 50 Hungarian engineering enterprises. Many of these enterprises also produced car components which were supplied to other CMEA countries and built into cars which were imported by Hungary in return for the exportation of buses. The second most important enterprise forming the recombinet was RABA, which produced engines and other parts for IKARUS. At the same time as the formation of Magyar Suzuki, RABA established a joint venture with GM-Opel in which is took a 21 per cent stake to produce engines and

assemble cars from imported kits. Not only did IKARUS, along with RABA, have a stake in Autokonzern but its subsidiaries also had their own stakes. Moreover, as IKARUS was an important customer in the sector it was able to exercise considerable direct and indirect influence over Autokonzern and Magyar Suzuki. However, the links between IKARUS and Magyar Sukuki were not confined to equity and hoped-for production collaboration as many of the first Hungarian managers which went to set up Magyar Suzuki had previously worked for one part or other of the IKARUS organisations. Thus, Magyar Suzuki's first managing director was formerly director of IKARUS itself, its sales director formerly worked for IKARUS's north American subsidiary and the purchasing manager had been a senior manager with its largest subsidiary, IMAG.

Weakness in the domestic market and the inability to export to either western Europe - because the 'local content' was below 60 per cent - nor eastern markets - because of high import tariffs and the absence of a dealer network - meant that daily production which began at the new factory in October 1992 did not rise above 60 to70 units until after the end of 1993, much later than had been scheduled (see table 5). Adapting to both the political changes in Hungary and the small and now open domestic market, Suzuki (re)conceived the project and shifted away from regarding the investment as a state sponsored top-down technology-transfer but as a fully integrated production base from which to supply the west European market. Thus, Suzuki Motor Corporation planned to transform the burden of having to modernise the Hungarian supplier base into a competitive advantage which could allow duty-free exports to west Europe by-passing the 'voluntary restraint' agreement between the EU and Japan (Sadler 1992). Crucially, this strategic shift meant that planned 'local content' had to be increased from 30 per cent to 60 per cent. However the geographical scale to which 'local' referred to was increased from Hungary to include the entire EU as well as its associated member states. In what followed Magyar Suzuki untied its ownership relations which wedded it to domestic industry and adopted strategies of inter-firm integration at the European scale.

The restructuring of the Ukrainian coal industry: 'decentralised-preservation' and the emergence of 'intricate networks'

A major feature of industrial transformation in Ukraine was partial marketisation which simultaneously involved both 'decentralised-preservation' and the continuation of, albeit at different and increasingly tangled spatial scales, pseudo-forms of central planning. In response to this was rapid growth in the informal economy involving 'capital flight' and an absence of foreign investment (table 1). As a result it was left to international institutions such as the IMF, World Bank and EU which operated at the national scale to provide the impetus behind economic change. Consequently both foreign investors and foreign institutions operating at the local and regional scales had little impact on industrial restructuring and regional development. Thus, van Zon (1998), in his case study of regional economic change in Zaporozhye, points to the inability of either a substantial automotive investment by Daewoo or the establishment of local economic development agencies funded by foreign donors to affect change to the regional economy due to the presence of intense localised coalitions spanning economic and political functions. Indeed, the on-going restructuring programme of the coal industry in the east of the country showed how the disintegration of central planning and later of the Soviet Union state itself involved a denigration of vertical linkage between institutions and the emergence of intense horizontal place-centred connections which linked mine directors, official and unofficial trade unions

and regional government officials. These introverted networks frustrated attempts by the new Ukrainian state, supported by the World Bank, to *de facto* nationalise coal mines as a necessary precondition for implementing coal mine closures. Likewise the reform and introduction of new local institutions designed to encourage the re-industrialisation of the Donbas coal field (comprising the easterly Donetsk and Luhansk Oblasts) seemed likely to have only a limited impact.

The newly independent Ukraine faced four dilemmas connected to the coal mining industry which went to the core not only of the formation of the new national-state but also, after 1994, policies aimed at Ukraine's (re)integration into the world economy. First, dependence on the industrialised and Russified east of the country which remained tightly integrated into the Russian economy endangered the integrity of the state. Second, as indicated above the central planning system bequeathed a set of powerful regional-industrial elites which vied with one another for not only control of the new embryonic state apparatus located in Kyiv but also for privileges for their industries/regions. Thus between 1991 and 1994 the state was unable to exercise control over the regions (van Zon 1998). Third, newly independent Ukraine inherited a negative energy balance which placed the coal industry in a particularly strategic position. Fourth, adoption of economic reforms similar to those pursued elsewhere in eastern Europe required a confrontation with the powerful coal mining industry lobby in the industrialised east of the country. As state support for the industry totalled 5 per cent of government spending in 1997 and the sector's debts were equivalent to 7 per cent of GDP (*Financial Times* 9.12.1997) the coal industry was a significant barrier to improving the state's financial position and the implementation of economic reforms.

In 1988, the Ukrainian Soviet Socialist Republic (SSR) produced 25 per cent of the Soviet Union's total coal production (Cole 1991, 42). Within Ukraine the coal mining industry was a highly significant sector employing at its peak around 1 million people and contributing 7 per cent of industrial production in 1990 (EIU 1997, 26). Moreover the industry was high geographically concentrated; in 1990 Donetsk and Luhansk Oblasts accounted for 193 of Ukraine's 276 mines, 80 per cent of coal production and 91 per cent of employment in the industry (see table 7; Swain 1998). During the Soviet era the coal industry was centrally controlled by the All-Union branch ministry for the coal industry located in Moscow. Individual coal mines within the same locality, which often employed more than 4,000, comprised several shafts and provided employment for more than one community, formed Regional Associations which were controlled directly by the Ministry. With 27 Regional Associations located in Donetsk and Luhansk Oblasts alone, the Soviet state established a Ukrainian Ministry for the Coal Industry in Donetsk. However, as this institution usurped the powers of Moscow and resisted economic reforms it was disbanded in 1986 and the associations subordinated to Moscow once more. Centralised control of the coal and associated heavy industries meant that 73 and 74 per cent of enterprises in Donetsk and Luhansk respectively were subordinated to All-Union ministries located in Moscow compared with an average of 56 per cent for Ukraine as a whole (Dolishnii 1992, 295). This centralisation increasingly became illusory. Thus in the early 1970s 12 collieries in the Donbas Region were earmarked for closure and a further 11 added by the time Ukraine secured independence (Dienes 1992, 139). Nevertheless in all that time not one mine in the region was formally closed, although mines regularly ceased production for lack of finance (Friedgut 1994). The inability to implement mine closures owed much to the privileged position the coal mining industry enjoyed within the Soviet Union and the Russian nationality of many of the Donbas miners. But also there was growing militancy at the local

level as enterprise directors were able to use their leverage over the locality to enlist support not only from coal miners and their official and unofficial bodies but also from local territorial institutions for their resistance to mine closures (Friedgut and Siegelbaum 1990).

With the dissolution of the Soviet Union and the formation of the new Ukrainian state the spatial scale at which the local coalitions and higher authorities engaged altered. Formally, the 39 coal industry Regional Associations located in what had been the Ukrainian SSR were subordinated to the State Coal Committee which was established in Donetsk. However, as in other coal mining regions within the former republics of the Soviet Union (Burawoy and Krotov 1995), the Regional Associations had already begun to partially dissolve involving the fission of pre-existing enterprises and the emergence of tangled formal and informal hierarchies, insofar as hierarchies existed at all, within the industry. In this way the new state was never able secure control rights over its industry. Thus by 1996, co-ordination of the industry having been transferred to a more powerful Ministry for the Coal Industry (MCI) located in Kyiv in 1994, 88 enterprises, including 12 (generally the most profitable) of the country's 276 mines, had already left the 39 Regional Associations (see Figure 2). One of those mines that became independent, was Zasiadko located in Donetsk, which established Ukraine's leading privately owned bank, the Ukraine First International Bank in 1991. This bank then began to play an important role in the coal industry in Donetsk as it became the banker for many of mines and other industrial enterprises in the area.

The organisational structure of the coal industry in Donetsk Oblast revealed the extent of the sector's disorganisation (Figure 3). The 115 mines located in the Oblast had been organised into eleven coal production associations. The Associations were territorially defined so all the mines in any one town or part of a town were members of the same associations. In addition the two largest Associations in the Oblast comprised a number of local or neighbourhood associations. By 1996, four of the 115 mines in the Oblast had become independent from the Regional Associations and nominally became directly subordinate to the MCI. Additionally the position within the Regional Associations was also becoming equally confused.

Donetskugol was the largest coal producing regional association in Ukraine which comprised 28 coal mines (mostly located within the boundaries of the city of Donetsk) and together with other enterprises employed 120,000 workers in 1992 (Figure 4). With Ukrainian independence, Donetskugol did not simply continue to be a production association fulfilling the plan imposed by higher authorities but adopted the roles formerly played by Ministries and became a planning agency itself setting prices (until State Coal Committee took over this role in early 1992) and organising supply and customer relations by barter - this had previously been the preserve of the local office of Uglesbyt, the state's monopoly trading company. Additionally, where this involved contacts beyond the Oblast, for example over the supply of steam coal to power stations, Donetsk regional administration entered into agreements with the other relevant Oblast (van Zon 1998). In this way the geographical scale of planning was transformed to the local and regional scale. With this in mind it is perhaps understandable why when given the opportunity all 28 mines within Donetskugol voted to remain part of the association. However, within the associations some mines became increasingly autonomous as planning at the local scale began to break down. Thus the position of mines within the association varied. There were those mines which were integral to the association itself, while others were subordinated to one of three local mine associations. Additionally a further six mines remained within the association but were classed as independent. At the same time new enterprises, whose ownership was often

confused, were established engaged mostly in trading activities unconnected to the coal industry.

As the industry institutionally fell apart employment and production declined rapidly. Table 7 reports that between 1990 and 1996 national production of coal declined by 57 per cent and employment by 38 per cent. In both cases these reductions were heavily concentrated in Donetsk and, to a lesser extent, Luhansk Oblasts (Swain 1998b). In response to the crisis in the industry the government attempted to impose tighter controls on the coal mining industry (but fell short of ending the scheme of centrally-determined prices) as a necessary precondition for implementing reform. This involved the government in Kyiv attempting to secure greater control over the Donbas region and its powerful coal-industry lobby. In contrast to 1993, when the date of the elections was brought forward by one year and members of the local elite were catapulted into the central government (Borisov and Clarke 1994, Borisov 1995), the miners strike in June 1996 indicated the growing weakness of the coal industry-Donbas regional lobby. Whereas prior to the election of President Kuchma, the Donetsk regional elite were influential in government circles, following the election there was a shift towards the Dnipropetrovsk Oblast elite, a centre of the iron and steel industry and industrial production for the military. With the appointment of a series of local leaders from Dnipropetrovsk culminating in the selection of Pavlo Lazarenko, the former Oblast Governor, as Prime Minister in May 1996, the new government, by then already negotiating with the World Bank, was powerful enough to propose the closure of coal mines and sought to do so in part to weaken the rival Donetsk regional elite.

Consequently, the fate of the coal industry became irrevocably intertwined with the struggle between the Dnipropetrovsk and Donetsk regional elites. The number of mines earmarked for closure ranged between 18 and 50 depending on which elite was more influential at any point in time. The battle between the elites culminated it the removal of key individuals in the Donetsk elite following the miners strike in June 1996. Vladimir Scherban, the Governor of Donetsk Oblast and a former Minister for the Coal Industry, together with his two deputies, were removed from office for having recognised the strike to attempt to secure greater regional autonomy. Additionally, the chief of the local television station and local security officials were removed from their positions and the co-chairman of the mineworkers' permanent Strike Committee was sent to prison in Zaporozhye. These changes weakened the Donetsk Oblast administration and the local elite lost its influence to affect the course of coal industry restructuring just as negotiations between the government and the World Bank about a local for the sector were nearing completion. However, whilst this may have been necessary it was not sufficient to disentangle the coal industry and enforce performance standards.

'Extrication' and 'Negotiation' in Hungary and Ukraine: Processes of disentanglement

Magyar Suzuki's 'extrication' from the 'recombinet'

From about the beginning of 1992 Magyar Suzuki began attempts to extricate itself from the 'recombinet' in which it found itself to be over-embedded. Thus it was constrained by its over-dependence upon weak state-owned engineering enterprises undergoing 'pre-privatisation agony' which not only sought contracts from the venture but also had a equity stake in it. Thus extrication from the recombinet involved two processes: disentanglement of

ownership relations from strategies of firm integration and 'Europeanisation' of the production chain.

The change in the strategic focus of the investment involved Suzuki Motor Corporation taking a much more active role in the management of Magyar Suzuki. In late 1993, a new group of more senior Suzuki executives arrived in Hungary to take control of the joint venture. At the same time many of the Hungarian managers who had formally worked for IKARUS left the venture. Also in December 1993 the capitalisation of the joint venture was increased to HUF14.2 billion which involved increasing Suzuki's share of the equity in the venture from 40 per cent to 55.2 per cent (table 5). Through Suzuki the venture entered into a strategic alliance with Subaru which involved selling Magyar Suzuki vehicles in Europe under the Subaru brand name. The recapitalisation of the venture not only increased Suzuki's share but also decreased Autokonzern's share holding from 40 per cent to 24.9 per cent. Also, in November 1995, the Autokonzern holding company was itself disbanded and it shareholders became direct stakeholder in Magyar Suzuki Rt. (Havas pers. com.). In May 1996 the balance between the major shareholders was altered once more. Thus Suzuki Motor Corporation's share was increased further from 55.2 per cent to 77.7 per cent and Autokonzern's share holding reduced from 24.9 per cent to just 2.4 per cent.

At the same time as the venture became more firmly controlled and owned by Magyar Suzuki the geographical distribution of value-added in the production chain altered dramatically. The proportion of value-added within the assembly factory increased from 19 per cent when production commenced in October 1992 to 24 per cent by December 1996 (see table 6). However, of more significance to the national economy was that the proportion of value-added undertaken by Hungarian firms, many of which had been share holders in Autokonzern, increased from 6 per cent in 1992 to 29 per cent by the end of 1996. Notwithstanding the beneficial effects this had on domestic industry, the size of the increase was misleading. Thus, the Hungarian content included the value-added in the process of manufacturing parts in Japan which were subseqently transported to Hungary where they were sub-assembled before being supplied directly to Magyar Suzuki as a Hungarian made part. Also the parts supplied by Hungarian firms tended to be low value added bulky parts, such as wiring harnesses and seats, where transport costs were a significant. Finally, Hungarian content included the supply of materials not directly related to production of automobiles. Moreover, the increase in the proportion of value-added supplied by firms located in the EU and associated member countries, from 4 per cent in 1992, 12 in 1994 and to 17 per cent in 1996 was particularly striking especially as these parts were directly related to production and were supplied directly to the assembly plant.

One of the major reasons behind Suzuki's attempt to extricate itself from the recombinet within which it found itself was the problems it faced in contracting local suppliers. As it looked increasingly towards the west European market it adopted a 'localization' strategy although it had no plans to alter its commitment to source high value-added parts such as the transmission and the engine from Japan. From the outset Suzuki sought to encourage co-operation between its suppliers in Japan and component producers in Hungary. Suzuki organised its first conference for suppliers in 1990 when it invited firms to offer to produce particular parts. Subsequent supplier conferences resulted in 129 companies showing interest in supplying the Japanese plant but only 25 of these were considered by Suzuki to be potential suppliers. After further auditing only 15 were deemed to be genuinely possible suppliers and only then once they had invested in Japanese technology. The first supplier to

be offered a contract was IMAG (IKARUS's subsidiary and seat supplier) which supplied seats and a number of other minor parts.

Production at Esztergom began in late 1992 with a 'local' value-added of 29 per cent (table 6). This comprised 19 per cent as part of the assembly process itself, 6 per cent from Hungarian suppliers and 4 per cent from suppliers in the EU or member states. Even this low figure was calculated on the basis of the ex-works price and thus included all costs related to production, including for instance depreciation on the buildings. As production began only two Hungarian firms were supplying Suzuki. Another ten Hungarian enterprises had been given official supplier status by Suzuki but that number included suppliers of goods and services peripheral to the assembly of automobiles, such as publicity materials. In April 1992, Osamu Suzuki, the president of Suzuki Motor Corporation, expressed dissatisfaction with the lack of progress over the local production of components. He cited three specific problems that Suzuki was having in identifying and contracting potential suppliers. First, he commented on Hungarian enterprises' unwillingness to make firm commitments and attributed this not only to a lack of western business skills (cf. Havas 1997) but also to the uncertainty stemming from the tortuous privatisation process that state owned companies were undergoing. One outcome of this contributed to the second problem: the near-insolvency of many of the potential suppliers, which hindered attempts to access credit to invest in new technology and licensing agreements. Thirdly, the Japanese company was disturbed by the high prices that potential suppliers were quoting, reflecting the difficulty they were having in trying to meet the much more stringent standards that Suzuki demanded.

To increase 'local content' Suzuki encouraged its suppliers in Japan to co-operate with Hungarian suppliers and arranged credit for them to purchase licensed technology. In practice Suzuki would only offer contracts to Hungarian suppliers which agreed to purchase licenses from its Japanese suppliers. In this way Suzuki was able to devolve responsibility for developing the local supply base to its major first tier suppliers in Japan. By the end of 1992 only four such agreements had been finalised and all involved the production of standardised low value-added parts. The most significant agreement was the purchase by IMAG of Mór, of a license from Houwa Kogyo to produce seats for Suzuki. IMAG, once one of Europe's largest producers of seats, with a capacity to manufacture 500,000 units annually, had been suffering from lost markets in east and central Europe as well as the contraction of bus production at IKARUS itself. However, as was common in Hungary's state owned industry IMAG was highly indebted and the agreement only went ahead after Houwa Kogyo agreed that half of the payment for the technology could be deferred by one year. The Hungarian company also agreed to pay a royalty for the right to produce the components. By the end of 1993 a further two licensing agreements had been signed.

Despite the signing of these agreements the problems surrounding Suzuki's supply base did not dissipate. This was largely because the Hungarian partners were unable to purchase the licenses or the technology required owing to a lack of capital and difficulty in accessing credit. Thus Berva (Eger) signed an agreement with Showa in 1991 but by the middle of 1993 the financing of the agreement had still not been resolved. As Suzuki became more dependent on increasing 'local' content it began to contribute towards the cost of purchasing licences and technology. By the middle of 1993 'local content' stood at 51.7 per cent comprising 21 per cent from the assembly process, 26.3 per cent from Hungarian suppliers and 4.4 per cent from suppliers in the EU. The 26.3 per cent sourced from Hungarian suppliers comprised the local production of 526 parts by 32 suppliers. Of these 32 local

suppliers just 13 were genuinely involved in supplying car parts. Thus the local impacts of the licensing agreements were limited as the value-added in Hungary remained low. A further five suppliers were located in the EU.

One reason for the slow development of the supply base was Suzuki's approach to auditing, selecting and managing its suppliers. Most Hungarian suppliers were unprepared for the rigorous and time consuming audit process that Suzuki established. Suzuki repeatedly audited potential suppliers demanding information on all aspects of their activities. Suzuki's auditing team were not only interested in technical capacity but also labour organisation, industrial relations, training procedures and long term business plans. Of particular sensitivity was Suzuki's demand to see detailed financial information which firms had not had to compile let alone supply to a potential customer before. In addition Suzuki was also very interested in the privatisation process of the firms concerned.

For Suzuki, price, quality and reliability were equally important. In negotiations Suzuki pursued a line which in effect meant that the prices were non-negotiable. Thus Suzuki, based on its production of the Swift in Japan, would declare what proportion of the car a certain part comprised and used this to calculate the appropriate price. Thus the starter motor was deemed to amount to 3 per cent of the value of the car so the part was to cost no more than 3 per cent of the price of the car in the market (around HUF1m in the middle of 1993) including a charge for the suppliers profit (officially around 5 per cent). In effect therefore, Suzuki used costs in Japan as a bench mark for costs in Hungary. Suzuki demanded that its suppliers costed everything connected to the production process. Costs were calculated on the basis of social costs per minute (wages and non-wage costs) in addition to material, process and transport costs. For the first time state owned producers had to calculate the costs of various activities with the result that overhead costs were revealed to be extremely high, so much so that Suzuki was unwilling to include them in calculating costs. The result was that suppliers felt Suzuki was not willing to pay the true cost of the activities they were contracted to do. As both sides were increasingly desperate for the agreements to succeed, compromises resulted in which Suzuki either paid more than it had previously been prepared to or disguised costs by leasing suppliers technology or by paying for the purchase of licenses, and on the other side the 5 per cent profit charge was squeezed to nearer 1 or 2 per cent as suppliers were keen to secure the business. Where the localisation of production was envisaged the contracts would include specific cost reductions to account for the cheaper costs associated with local manufacturing rather than importing parts from Japan.

With respect to quality Suzuki examined its potential suppliers very closely. In general Suzuki stipulated as a condition of contracting a supplier that it introduced quality assurance systems such as the ISO 9000 series. However, in reality quality control of suppliers was devolved to its Japanese suppliers from which the local suppliers purchased licenses. Thus licensers were responsible for testing and checking the quality of parts assembled in Hungary. Also all agreements included a clause that if the quality of supplies from the local firms was inadequate the Japanese partner would fly in replacement parts at their expense. This meant that Suzuki's Japanese suppliers showed a close interest in their licensees and sent over experts several times a year (at the expense of the Hungarian firms) to check the quality of local assembly operations and also of sub-suppliers. Clearly, concerns over quality in local firms delayed the localisation of production and where localisation took place the Japanese firms had to guarantee quality. In practice the Japanese partners controlled the machines and the production processes in the Hungarian firms.

Suzuki's Hungarian suppliers were also struck by the Japanese approach to reliability and other supply issues. The contracts between Suzuki and its suppliers stipulated 'just-in-time' delivery (the frequency depended on the volume of production at Esztergom). The contracts also included a clause that the supplier was liable for all costs resulting from a disruption of production due to late delivery. As a consequence all the local suppliers maintained a reserve inventory of finished products (of up to 4 days of production) in case of production problems, a cost they were unable to pass onto Suzuki directly. Through its relations with its suppliers Suzuki was also able to place the burden of storing unfinished goods on local firms. Thus those firms which assembled components from parts shipped from Japan were squeezed by their suppliers and Suzuki. As the volume of production increased more slowly than was intended, shipments from Japan to local suppliers occurred at infrequent intervals - often once every three months - but they were required to supply 'just-in-time'. In this way Suzuki passed on the cost of storing unfinished components on to its Hungarian suppliers - which were not well positioned to account for the financial burden. Hungarian firms were also struck by some of the other conditions that Suzuki placed on them. In all cases the supplier was responsible for the transportation of the parts to Suzuki's factory and in some cases suppliers were requested to alter or design completely new forms of packaging and storage to permit ease of transportation and enable parts to be shipped straight to the line without the need for additional handling.

To those firms which were designated as official suppliers, the Japanese firm offered the prospect of a long term mutually beneficial business relationship. The suppliers characterised the relationship more as a technical assistance agreement rather than a standard contract between an assembler and a component producer. Thus the contracts that were signed between Suzuki and local suppliers were open-ended and efforts to develop a co-operative relationship were evident. Suzuki set up a three month long supplier development course funded jointly by UNIDO and the Japanese government to work especially closely with 12 suppliers which aimed to develop Japanese production methods in the fields of quality assurance and team working in particular. More generally Suzuki was also a leading force behind the establishment of the Hungarian Association of Automotive Component Companies which was designed to raise the quality standards of the local supply base. Intriguingly the other stated purpose of the Association was to facilitate Hungarian suppliers to find customers other than Suzuki to enable them to become more financially secure owing to larger production runs. The Association - which was entirely funded by the fees of the 30 members (comprising traditional as well as new component producers and consultants) - provided advice and services connected to quality assurance systems, investment financing, and foreign business contacts. Suzuki hoped too that the Association would lobby the Hungarian government for assistance and would co-ordinate applications to the various industrial development funds that existed.

The relationship between Suzuki and its local suppliers became closer in the face of adversity. To assist local firms to finance capital investment so that Suzuki could develop a local supply base the Hungarian government underwrote a Japanese loan through Eximbank which was to be disbursed by Hungarian commercial banks to Suzuki's suppliers. However, owing to the risky business environment the Hungarian banks did not pass on the 'soft' repayment terms connected to the loan which meant that Hungarian suppliers dare not take the loans at such high interest rates whilst Magyar Suzuki had yet to increase the volume of production. The result was a chronic shortage of capital amongst the suppliers which

hindered the purchase of licences and technology. In response Suzuki began in certain circumstances to offer to pay for the purchase of licenses to enable local sourcing of significant products such as the starter motor. In addition Suzuki started a scheme of purchasing capital goods (machine tools) and locating them in supplier factories to increase local content. Where this took place the costings of supply contracts took this into account and included a clause that after a certain production volume the ownership of the capital goods were to be transferred to the supplier.

However, far from being mutually beneficial, Hungarian suppliers argued that the closeness of the links between them and Suzuki was asymmetrical. Thus many were critical of Suzuki's insistence that they had to purchase licences before being given official supplier status, a condition which sucked them dry of precious funds for capital investment. They expressed concern too that Suzuki was more interested in protecting its Japanese suppliers' businesses rather than assisting in the creation of a low-cost high quality supply base that would be in competition with its existing suppliers in Japan. It was noticeable in the light of this that where licence agreements were reached they placed restrictions on local firms. In almost all cases the contracts made between Suzuki, its Japanese supplier and the Hungarian supplier in practice, if not in theory, prevented the Hungarian firm from supplying other Suzuki plants across the world. Other licence agreements for the production of generic products which could be sold to other car manufacturers, such as shock absorbers, prevented Hungarian suppliers from supplying customers in western Europe. In effect the licences meant that the European market was divided into two, permitting the Hungarian firms the chance to develop markets in east and central Europe but leaving the Japanese firm free to supply customers in western Europe.

Thus, Suzuki's extrication from the 'recombinet' was complex. It involved securing greater control over the joint venture by excluding shareholders. It also involved attempts to Europeanise the production chain. However, this was achieved at the expense of becoming more closely connected to a small number of Hungarian suppliers in order to ensure its products conformed to EU regulations on 'local content'. But even in the development of these closer ties Suzuki sought to limit its exposure to uncertainty arising from suppliers financial problems and privatisation through the device of licensing agreements between its suppliers in Japan and suppliers in Hungary

Attempting to dismantle the Ukrainian coal industry through negotiation and central planning

Negotiations between the Ukrainian government and the World Bank about a coal industry sector adjustment loan or Coal SECAL began in early 1995. As the negotiations proceeded and the reform programme took shape so the relationship between negotiating the construction of institutions and adoption of reform goals became increasingly clear. Thus the procedures adopted involved the formation of mechanisms for negotiation such as the production of World Bank documentation, the strengthening of national-state institutions (especially the Ministry for the Coal Industry) as a means to attempt to exert control over the ungoverned industry to permit centrally *planned* mine closures, and the creation of institutions in the coal-fields to encourage re-industrialisation.

Each phase of negotiations had a series of specific conditions attached which had to be implemented before the next phase of discussions could begin. The World Bank offered the

prospect of three separate loans. The first was to be a small pilot loan to begin the process of reform in the crucial Donetsk Oblast. This was to be followed by the nation wide coal SECAL and a third loan to provide finance for investment in the trimmed down industry. The first two loans were due to commence in 1996 and the third loan in 1998 (table 8). The sequencing of these loans was highly significant in terms of securing the governments agreement to rationalising the industry and preparing public opinion for the ensuring social implications. With its focus on environmental clean-up and job creation it was significant that the first loan was to be implemented as negotiations on the coal SECAL, which would involve a mass coal mine closure programme, were to conclude.

There was thus instituted a procedure by which World Bank advice was legitimated through its adoption by the parts of the government. At the same time the UK Know-How Fund provided direct advice and assistance to the Ministry for the Coal Industry. In these ways the World Bank was able to enlist support for the reforms from a small number of key people within the Ukrainian government and at the same time prepare medium ranking officials in the coal ministry for their implementation before confronting more hostile interests. Production of the Ukraine Coal Industry Restructuring Sector Report by the World Bank (which was later published (1996)) was the procedural device for negotiating the agreement on the 'Coal SECAL'. It involved the establishment of a separate policy unit comprising World Bank staff which provided the government with an alternative source of policy advice on the coal industry and thus undermined the influence of the MCI. In this way the Bank was able to shape government policy for more than a year before the loan was agreed. The Sector Report involved a comprehensive analysis of the industry by World Bank officials based in part on research commissioned from the Donetsk Coal Mining Research Institute. In it the Bank discusses the need for the liberalisation of the market for coal, for the closure of uneconomic mines, for the corporatization of coal mining enterprises, and specifies the detailed procedures for implementing mine closure and for increasing productivity at open mines. In particular the World Bank argues that the government's then intention (1995) to close 39 mines was too limited to secure the industry's competitiveness suggesting instead that at least 75 closures were necessary (World Bank 1996, 28). The need for widespread mine closures was based on an audit of all mines carried out in 1995 by the MCI and reported in the Sector Report. According to the audit, each mine was allocated to one of four categories: category one for unsubsidised profitable mines, category two for mines thought potentially profitable with access to capital for modernisation, category three for mines operating unprofitably and scheduled for closure, and category four for those mines where production had already ceased but where formal closure had not yet occurred. According to the audit the Ministry placed 57 mines in category one, 161 in category two, 15 in category three and 24 in category four (see Table 9).

The presentation of the sector report became an exercise in consultation to secure support for the proposed reforms. In particular the report was discussed at a conference in London in early 1996 involving experts who had been involved in the restructuring of the UK coal mining industry. This was followed by a further conference in Kyiv in April 1996 attended by mine directors, government officials, as well as workers representatives and parliamentarians. At this meeting the World Bank argued for the closure of 80 mines, well above the government's figure of 39 at the time, and generated considerable criticism of the planned changes from the delegates (*Economic Review* 29 April 1996). The report's findings were also the subject of a series of consultative meetings in coal mining regions. In this way

the preparation and presentation strategy of the report generated opposition only after the need for reforms had already been accepted in most government circles.

Thus even before the conference in Kyiv the government had adopted the reforms which had been identified as conditions to be met prior to the World Bank agreeing to the SECAL. In this way the report and its recommendations formed the basis for the Government's coal industry policy announced in decrees in February and March 1996. In March 1996 the MCI set up a subordinate agency entitled UkrVuhleRestrukturyzatsiya (UDKR) or the Ukrainian Coal Restructuring Company located in Donetsk. The institution, led significantly by Oleksandr Postuk, a former deputy coal minister based in Donetsk, was to manage the technical, social and environmental aspects of mine closures. By the end of 1996 coal mining had ceased in 25 collieries and half of these were transferred to UDKR for closure. Also in early 1996 the government ended the price system under which low cost mines subsidised high-cost mines and ended the monopoly on the sale of coal (IMF 1997).

Following a visit by World Bank's Vice President Johaness Lynn to Kyiv to discuss reform of the industry (Economic Review 29 April 1996) the Bank agreed, in May, to the first loan for the industry. The 'Coal Pilot Loan' was to focus on environmental clean-up and job creation and became effective in August of that year. This loan provided USD15.8m towards a USD28.5m project to close three unprofitable mines, Red October, Pravda and Promeskaya, in Donetsk Oblast. Significantly the loan was directed at Donetsk (involving budget transfers to the Oblast administration) and was designed to construct institutions to mollify opposition to the proposed reforms. The loan was designed to generate the institutional framework needed for the larger reforms and play a crucial demonstration role. In particular the loan supported the establishment of UDKR. This involved establishing a British Know-How Fund project designed to transfer technical knowledge of restructuring the coal industry to UDKR officials. This involved the establishment of an office attached to UDKR run by UK-based consultants (four were permanently based in Donetsk and a further 32 specialists rotated) to improve its institutional capacities, provide policy advice and technical assistance.

The pilot-project involved UDKR elaborating plans for the technical closure of the underground facilities and the demolition of surface facilities, the design and implementation of environmental and social mitigation measures. In particular UDKR piloted a micro-credit scheme to assist former miners to start their own businesses, a temporary work programme in which former miners were placed on public works projects and the transfer of social amenities to the relevant local authorities. Connected to this was the aim of devising public information strategies (and monitoring procedures) designed to ensure effective publicity of the social mitigation measures. It was significant that when setting up a survey panel and a ethnographic study of the responses of miners and their families to closures and social mitigation measures UDKR opted to employ researchers from the neighbouring Oblast of Kharkiv rather than involve local universities. The closure of the three mines was thus used to devise, implement and train local officials in a set of procedures with a view to the introduction of mass closures and two further loans. Moreover, it produced an institutional framework in which the World Bank via the KHF consultants and UDKR could ensure tight control over the process of coal mine closure and social mitigation procedures.

As the coal-pilot loan became effective negotiations on the coal SECAL were nearing completion. The coal SECAL, worth USD 300 million to be disbursed in two tranches of USD 150m was agreed and made effective in December 1996. The loan was payable over 17

years with repayments beginning after five years. The responsibility for administering the loan was given to the Ministry of Finance whilst the MCI was to be responsible for implementation of the agreed sector policy. In this way the Bank took measures to reduce the potential of resistance emerging in the coal ministry. The agreement between the government and the World Bank included a series of conditions to be met prior to the release of the second tranche of money in mid-1997. These included continuation of the policies adopted prior to the loan and maintaining the conditions to be attached to government financial support to mines and the transfer of social assets to local authorities.

Whilst the agreement did not contain a figure for the number of mines to be closed it is possible to calculate from the loan agreement the anticipated range of likely closures. Significantly the division of the country's 276 mines into one or other of four categories (see above) was revised following pressure from the Bank (table 9). The number of mines in category one and thus not under threat of closure increased from 57 to 76. However, the number scheduled for closure increased from 39 to 95. The number of mines in category two, those given a year to demonstrate profitability, declined from 160 to 105. It was anticipated that half of the category two mines would eventually be closed. Additionally, the number of mines allocated to category four was increased from 20 to 40. Thus the minimum number of closures up to 2004 was to be 95 mines and the maximum around 150. In a document of the government's coal industry policy attached to the loan agreement they committed themselves to closing a minimum of 20 mines per year. From this the World Bank calculated that the restructuring programme would involve 184,243 compulsory redundancies of which around 60,000 were to be in the year 2000 alone. Taking into account voluntary redundancies it could be expected that total employment in the industry would fall from 465,000 in 1996 to around 200,000 by 2004 (employment in the industry was 755,000 in 1990 (Swain 1998b)).

An important feature of the restructuring programme was the organisation of mine closures. Under the programme the formal closure of mines (those in category three and four) was not to be implemented by the Regional Associations nor directly the MCI but by its agency, UDKR. Through the pilot loan project UDKR was equipped to implement the closure programme and tight forms of control were created which allowed the World Bank team in Kyiv to closely control and monitor the agency's operations. This institutional framework was designed to ensure that state funds allocated for the financing of mines closures went directly to UDKR where it could be spent on its intended purpose rather than flowing through the MCI to the Regional Associations where, the Bank feared, it would be used to subsidise loss-making production and finance investments. In this way the most cash rich part of the industry was that to be closed. Indeed it meant that as UDKR had money to meet social liabilities the option of formal closure raised the prospect of the payment of wages, pension and other social benefits. A financial incentive for implementing mine closure was thus duly established. Following UDKR's formation in March 1996 28 mines, predominantly in Donetsk Oblast, were transferred from the Regional Associations for formal closure.

Mines in category two and three were eligible to receive for a period of time production subsidies. In the case of category two mines, production could not be subsidised beyond the end of 1997. Arrangements for category three mines were more complicated as they were scheduled for transfer to UDKR and for formal closure in the 'medium term'. Mines in this category were transferred from the Regional Associations and placed under the direct control of the MCI. This centralised control over the industry and involved the creation of divisions,

organised by Oblast, within the ministry to manage the mines directly from Kyiv. Moreover these Oblast divisions were also responsible for distributing production subsidies to the mines placed in category two. This change had significant implications. First, it involved a recognition of the limitations of the ministry's control over 'its' industry and a strengthening of its institutional capacities. Secondly, and connected to this process of centralisation, it involved *de facto* re-nationalisation of a section of the industry as a necessary precondition for ensuring the implementation of *centrally planned* mine closures. Thirdly, the arrangements included a discretionary element in the form of the distribution of subsidies. Scope was thus maintained for selective bargaining between the mines and the ministry over individual mines' financial conditions in much the same way as had existed under central planning and continued after Ukrainian independence. There was also scope for bargaining over which category a mine was to be placed in. As a result mines were transferred from category to category depending on the influence mine directors exercised within the ministry at any given point in time. Fourthly, the transfer of the mines to the MCI was designed to ensure the economic viability of the Regional Associations prior to corporatisation and eventual privatisation.

The mines allocated to category one (and those moved from category two to category one after one year), that is between 170 and 120 mines, were to be corporatised and grouped to form 15 regional holding companies owned by the MCI as successors to the Regional Associations (Figure 5). It was envisaged that eventually the shares in the holding companies would be privatised. In this way the section of the industry deemed to be internationally competitive was to be subjected to the rigours of the international coal market and raise investment capital through capital markets. However corporatisation involved the division of debt liabilities between different legal entities. Moreover it also involved the transfer of social assets from the mines to district authorities which required the provision for additional budget transfers to the Oblasts administrations to assume the extra responsibilities. This proved a convenient means of securing support for the reform programme from Oblast administrations.

Despite the carefully negotiated development of the reform programme and the MCI beginning the long process towards eventual privatisation in April 1997, reforms slowed with a change of the coal industry Minister on 25th July 1997. Rusantov, a former director of a Regional Association, was replaced by Stanislav Yanko who had been the First Deputy Manager of the State Coal Committee from 1992 to 1994, and who had then become a deputy in the *Rada*. In particular he used his position in the *Rada* to secure backing for his arguments with fellow ministers over budgetary support for the coal industry. Following his appointment Yanko argued that Ukraine's energy deficit meant the coal industry was 'strategically important' and argued for government backing for the expansion of coal production from 75 million tons to 100 million. As a result he sought a Hyn. 1.5bn increase in the 1997 allocation to the coal industry to Hyn. 4-5bn to permit investment in category 1 and category 2 mines. Crucially, it was the Word Bank's view that only category 1 mines should receive investment capital and only then in the form of soft loans for projects with an expected rate of return of not less than 15 per cent. Moreover whereas the loan agreement implied the closure of more than 100 mines the new minister indicated that UDKR would only close 52 (*IntelNews Business Journal* 8.9.1997).

Additionally the closure programme itself became bogged down in technical difficulties with the result that by the end of 1997 not one mine had been formally closed (*Financial Times*

9.12.1997). In particular the confused economic situation, in which people either worked for their enterprise without pay (and often for private gain) or did not work for their enterprise but remained unsalaried employees in order to secure non-wage benefits, meant there were mines in the process of being formally closed which continued to produce coal whilst mines that were technically open had ceased production. The formal closure of mines was prevented due to the difficulty of transferring social assets to local Oblast administration which, in the case of Donetsk, were unwilling to accept them without prior renovation. Additionally, the division of assets and liabilities between UDKR and the Regional Associations in the course of closure became a controversial issue. Connected to this was the problem of money allocated to UDKR not reaching the intended recipient. In 1997, some Hyn. 200 million of the coal industry budget was allocated to UDKR. However, by the end of September that year only Hyn. 70 million had been received. In part this was due to the redirection of money allocated to implement closures to provide investment capital in the few profitable mines. Initially money due for UDKR arrived from the World Bank via the Ministry of Finance and the Ministry for the Coal Industry. In order to prevent money being redirected by the MCI to Regional Associations the transfer of money was altered so funds reached UDKR via the Oblast administrations where it was working. However, as money continued to go missing *en route* to UDKR the procedure was changed once again so that money passed from the World Bank via Donetsk Oblast to UDKR.

Although 28 mines due for immediate closure were transferred from the Regional Associations to UDKR as stipulated by the loan agreement the transfer of the other 12 mines scheduled for closure became a topic of disagreement between the World Bank and the MCI. Although according to the loan agreement mine closures were to be implemented solely by UDKR coal industry minister Yanko indicated that the 12 smaller mines would be closed by the Regional Associations. This decision had important implications for the financing of the sector as it implied that budget transfers which had been scheduled for UDKR would be redirected to the Regional Associations, breaking one of the conditions of the loan which stipulated state financing for the coal industry in composition and in aggregate. However, more importantly Yanko's decision reflected the enduring inability of the MCI to exercise control over 'its' industry. In particular it was in no position to rein-in those mines which had left their Regional Associations and which were effectively beyond the ministry's reach (*IntelNews Business Journal* 8.9.1997). This was reflected in the MCI's failure to transfer category three mines from the Regional Associations to the MCI which meant the Associations remained unprofitable and continued to receive state subsidies. There was also disagreement over how many holding companies should be created in the wake of the associations. The MCI sought the creation of 18 holding companies whereas the loan agreement stipulated and the Bank sought just 15. Moreover as production costs in the industry increased dramatically in the course of 1997 according to World Bank officials nearly 200 of the 276 mines were unprofitable which if correct implied the need for between five to seven holding companies in the longer term (interviews September 1997).

A further point of contention between the Bank, the MCI and UDKR focused on the technical costs of coal mines closures and on the costs of social mitigation. Firstly, the high costs of closing mines stemmed from the willingness of mine authorities and workers to remove assets even at costs substantially greater than the assets being recovered. However, for the employees concerned the economics of this activity were largely irrelevant as the reclamation of even scrap metal was for private rather than the enterprise's gain. Indeed given the widespread recycling of public goods for private gain the prospect of closing a mine offered

employees, which had not been paid for many months, opportunities for securing an illicit income. Secondly, the proposals emanating from the industry design institutes, which were responsible for devising alternative employment strategies, were reminiscent of state plans and involved variously the construction of new mines and the establishment of factories. The average cost per job according to these proposals was USD30,000, equivalent to 45 years of the average salary, and was considerably higher than the World Bank's preferred figure of USD10,000. Moreover the Bank sought temporary employment schemes rather than the setting up of alternative businesses.

As a result of these problems and disagreements between the World Bank and the MCI the second USD 150 million tranche of the Coal SECAL, which had been due for disbursement in the middle of 1997 had yet to be released by the beginning of 1998. Moreover, the prospect of the third of the World Bank coal industry loans, the 'coal mining improvement project' worth USD 100 million, which was due to be agreed in early 1998 receded further into the future. In consequence the section of the industry which was to form the basis of a trimmed-down internationally competitive sector was starved of the investment capital required to maintain current production and productivity levels whilst the theoretically cash-rich mines due for closure remained open to the difficulties of implementing closures.

Thus, by the end of 1997 a policy to close a significant proportion of the coal industry had in principle been adopted by government, mine directors and trade unions and reluctantly by Oblast administrations. This adoption had been co-engineered through the constitution of an institutional framework designed not so much to plan coal production as to enforce the planned dismantling of the industry. However, despite this, not one mine had been formally closed. Moreover, attempts to revitalise the local economies effected by de facto closures and the transfer of social assets had become bogged down in bureaucratic wrangling.

Conclusions

From this analysis we can identify two very different forms of 'institutional failure' in two regional economies in ECE. I have argued that in response to the interplay between interwoven forms of governance (ownership) and interwoven strategies of enterprise integration in Hungary, Magyar Suzuki sought and was largely successful in extricating itself, and by means of the conditions it attached to supply contracts encouraged its most important domestic suppliers to follow suit, from its position within a 'recombinet'. This involved the closer integration of the joint venture into Suzuki Corporation global organisational structure, a significant dilution of the share of ownership allocated to Hungarian enterprises and the sourcing of components from outside Hungary. This was a significant process of institutional change for two reasons. Firstly, of all the major foreign automotive investments in Hungary, Magyar Suzuki was likely to be the most locally integrated in terms of ownership and supply linkages and so the 'disembedding' of the investment over a number of years further reinforced the conclusion that the path of economic and industrial reform in Hungary actively encouraged the formation of cathedrals in the desert (Swain 1998a). Secondly, and connected to the first point Suzuki's extrication indicated the weakness of decentralised-reorganisation and 'recombinets' to create the untraded interdependencies and local industrial atmosphere needed to pin-down foreign investors and encourage regional development.

The analysis presented here has suggested that the reasons for this institutional failure lay in the asymmetrical relations that existed between the institutions involved. Particularly

important was the weakness of the Hungarian Ministry of Industry (see Amsden et al 1994, 119) and other advisory organisations designed to encourage industrial modernisation and technical development to pin down investment. Connected with this, most of the bidding by the central state was made through the intermediaries of the state owned automotive enterprises themselves, such as IKARUS. However, these indebted organisations undergoing 'pre-privatization agony' were in a very weak position to respond to the demands placed upon them by Magyar Suzuki. Instead Suzuki became embroiled in the paralysis of their position. Additionally in the absence of a regional tier of local government and a weak county tier which concentrated on real estate development, local institutions were not able to guide foreign investors. As a result the role the automotive industry played in guiding the selective integration of parts of the Hungarian space-economy into the global capitalist system tended towards the exclusion or 'locking-out' of domestic producers from the pan-European corporate networks which increasingly dominated the European automobile industry. At best those few firms that were locked-in to the industry became dependent on the enforced purchase of Japanese licenses and technology or were forced down to the second and third tier of suppliers servicing larger component suppliers in the European car industry. In sum the 'recombinet' proved to be not so much a resource for the future as a form of paralysis which acted as a barrier to industrial restructuring and regional development.

By contrast in Ukraine the coal industry reform programme sought to disentangle (by dismantling) the complexity created by decentralised-preservation and institutional fission which formed a highly inappropriate form of 'institutional thickness'. This complexity involved the creation of intricate localised coalitions comprising coal mine enterprise directors, official and unofficial mineworkers' organisations and local Oblast administrations locked into a mutually reinforcing dependence on each other. In this way industrial and territorial institutions were too closely integrated which served to lock-out foreign and domestic corporate and non-corporate institutions which could have facilitated industrial and regional development. In the absence of new institutions the coal industry crisis spiralled out of control and undermined the regional economy. Although in the process of designing a reform programme for the industry the World Bank attempted to institutionalise the negotiation and adoption of industrial and regional restructuring goals, this was confined to a narrow technocratic section of the population. However, the Bank's efforts foundered on the dense local networks and short-term sectional interests which formed the basis of resistance to mine closures and re-industrialisation. As a result the disentanglement of these networks through planned dismantling of the industry failed. This institutional failure was in large part due to the weakness of the national-state in relation to the powerful institutionalised coal industry-Donbas regional lobby and thus its inability to secure control over 'it's' industry and 'it's' regions. One reason for this was that the negotiated strategy adopted by the World Bank and the national-state excluded the regional administration which subsequently became the core of the resistance to the reforms.

Thus the comparative analysis presented here points to three particular features which have a bearing on processes of institutional change and regional development. Firstly, where there is a significant asymmetry in the relative power of different types of institutions and particularly where the national state is weak, barriers to institutional change can emerge. Secondly, institutional asymmetry results from institutional frameworks which are either too cohesive (Ukraine) or not cohesive enough (Hungary) and in both cases retards strategic collective action. Thirdly, the passive absence and/or active exclusion of particular types of institutions may prove to be one of the main causes of 'institutional failure'.

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Table 1 Direct Foreign Investment in east and central Europe and the former Soviet Union 1989-1995 (billion USD)

	1989	1990	1991	1992	1993	1994	1995	Total
Hungary	**187**	**311**	**1,459**	**1,471**	**2,339**	**1,146**	**4,453**	**11,366**
Czech Republic		120	511	983	517	850	2,500	5,481
Russia		-400	-100	700	400	1,000	1,500	3,100
Poland			117	284	580	542	900	2423
Kazakstan					473	635	723	1,831
Romania				77	94	341	367	879
Estonia				58	160	214	204	636
Slovak Republic				100	156	187	180	623
Ukraine				**170**	**200**	**91**	**120**	**581**
Slovenia		1	41	113	112	88	150	505
Latvia				43	51	155	160	409
Turkmenistan				11	104	100	100	315
Bulgaria				42	55	105	100	302
Azerbaijan			0	0	20	50	206	276
Uzbekistan				9	48	85	120	262
Croatia				13	72	98	68	251
Lithuania			25	27	61	60	55	228
Albania				32	45	53	70	200
Kyrgyzstan					10	45	88	143
Moldova					14	18	63	95
Belarus			50	7	18	10	7	92
Tajikistan				8	9	12	13	42
FYR Macedonia						24	14	38
Armenia			0	0	0	3	19	22
Total	187	32	2,103	4,148	5,538	5,912	12,180	30,100

NB: no data for Georgia
Sources: EBRD Transition Report 1995, 1996 and authors calculations

Table 2 Major automotive foreign investments in Hungary, end 1996

Investor	target	activity	Location	USDm	empl.
Audi (G)	greenfield	engines, and cars	Györ	600	600
GE (US)	Tungsram	auto lighting	Budapest	600	10,400
GM (US)	Raba	engines and cars	Szentgotthárd	287	850
Suzuki (J)	Autokonzern	cars	Esztergom	280	850
Ford (US)	greenfield	components	Székesfehévár	150	500
Alcoa (US)	Kofem	aluminium parts	Székesfehévár	146	1,957
Guardian (US)		float glass	Oroshaza	120	250
Columbian Chems. (US)	TVK	rubber	Tizaujvaros	55	70
ITT (US)	Bakony and greenfield	electrical parts	Veszprém	62.4	200
ATEX (R)	Ikarus	buses	Budapest	50	2,500
VAW (G)		engine parts	Györ	40	n.d.
UTA (US)	greenfield	wiring harnesses	Gödöllö	20	500
Loranger (US)	greenfield	electrical parts for Ford	Székesfehévár	10.1	250
Packard Electric (US)	greenfield	wiring harnesses	Szombately	8.3	380
Michels (G)	greenfield	wiring harnesses	Mór	8.3	350
Linamar (Can)	Mezogep	vacuum pumps	Oroshaza	6	nd
Sumitomo (J)	IMAG	wiring harnesses	Mór	nd	nd
TOTAL				2,443.1	19,657

Table 3 Inflows of USD millions by mode of entry presented as percentages

Country	Acquisitions	Joint ventures	Greenfield investments
Czech Republic	63	32	5
Hungary	35	36	29
Poland	56	31	13
Russian Fed.	11	88	1

Table 4 Magyar Suzuki production, sales and employment

	1992	1993	1994	1995	1996 (plan)
Production	992	13,021	19,412	35,000	52,000
Domestic sales	929	12,537	16,065	12,178	15,000
Export sales			3,309	23,873	37,000
Employment	345	489	857	1,200	1,200
cars per employee	2.89	26.2	22.7	29.2	43.3

Source: after Havas 1996, 5

Table 5 Magyar Suzuks's ownership structure (percentages)

	Apr. 1990	Dec. 1993	May 1996
Equity (billion forints)	5.5	14.2	14.2
Suzuki Motor Corporation (Jap.)	40.0	55.2	77.7
Itochu trading house (Jap.)	11.0	13.6	13.6
International Finance Corporation (World Bank)	9.0	3.5	3.5
Autókonszern Rt. (Hun.)	40.0	24.9	2.4
Hungarian Investment and Development Bank Ltd (Hun.).	-	2.8	2.8
Total	100	100	100

Note: Autókonszern was dissolved in November 1995. Its former members became individual shareholders of Magyar Suzuki.
Source: Havas, 1996, 4

Table 6 Distribution of value-added at Magyar Suzuki (percentages)

	Oct 1992	Jun 1993	Dec 1993	Dec 1994	Dec 1995	Dec 1996 (est.)
Magyar Suzuki	19	21	23	23	23	24
Hungarian suppliers	6	26	25	27	28	29
EU suppliers*	4	4	11	12	14	17
Japanese suppliers	71	49	41	38	35	30

* including associated member countries
Source: Magyar Suzuki in Havas 1996, 6; authors' interviews

Table 7 Change in coal production and employment between 1990 and 1996, by Oblast (percentages)

Oblast	No. of Mines (1996)	Production	Employment
Donetsk	115	-52.3	-23.9
Lugansk	78	-66.2	-59.5
Dnipropetrovsk	nd	-27.1	18.8
Lviv	14	-64.4	-28.2
Kirovohrad	nd	-82.0	-26.9
Cherkasy	nd	-69.4	-27.6
Zhytomyr	nd	-93.8	nd
Ukraine	276	-57.2	-38.4

Source: Swain 1998

Table 8 World Bank loans for the Ukrainian coal mining industry

Name	Date agreed (implementation)	Value m USD	Location	Details
Coal pilot project	May1996 (Aug)	5.8	Donetsk	Mitigation of social and environmental consequences of closure of 3 coal mines
Coal sector adjustment loan	Dec 1996 (Dec)	300	Nation wide	Implementation of economic restructuring of the coal sector
Coal mining improvement project		100		Improvement of mine safety and coal quality; social mitigation of restructuring

Source: World Bank 1997

Table 9 Coal Industry Restructuring Plan

Category	Action	No. of mines Feb-1995	No. of mines Nov-1996	No. of mines Sept-1997
1	Reorganisation into 15 regional holding companies	57	76	76
2	Given one year (end 1997) to demonstrate viability	161	105	105
3	Scheduled for closure in the medium term	15	75	35
4	Immediate closure	20+	20	40

+ mining ceased at 24 collieries but four of those were merged with existing mines.
Note: The discrepancy in the number of mines between 1995 and 1997 which is due to the merger and de-merger of mining establishments

Source: World Bank 1996, 28, and interviews, September 1997

Map 1 Ukraine

Figure 1 An Hungarian ‘recombinet’

Figure 2 Organisational structure of the Ukraine Coal Mining Industry, 1996

Figure 3 The organisational structure of the coal mining industry in Donetsk Oblast, 1996

Figure 4 Organisational structure of the Donetskugol Regional association

Figure 5 The World Bank's proposed structure for the coal industry

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