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**Integrated Structures, Market Forces and Competition in Russia's
Agro-Food Sector: An Assessment from the Perspective of the Aus-
trian School of Economics**

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**Paper prepared for presentation at the 102th EAAE Seminar ‘Superlarge Farm-
ing Companies: Emergence and Possible Impacts’, Moscow, Russia, May 17-18,
2007**

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1. Introduction

A surprising development in the Russian agro-food sector is the emergence of large groups of companies. A common feature of them is that they were created by operators from outside primary agriculture like food processors or food traders but also from the energy, financial or metallurgy sector. As a result these structures are often vertically and in the latter case also conglomerate integrated. However, differences exist with regard to the kind and number of stages of the supply chain that they cover, the degree of legal and economic independence of the subsidiary and/ or cooperating enterprises and the organizational structure.

So far, there is no accepted name for these new players. In the Russian literature you find terms like integrated structures, holding-type agro-industrial formations (e.g. VNIIESKh, 2002) or New Agricultural Operators (Rylko, 2005, p. 116). The most popular and widespread name is “agroholdings”. This is why this term will be used in this paper, too. However, the term “agroholding” has the disadvantage of saying nothing about the scope of operation and of ignoring differences in the organizational form (holding-type or not). This is why the author prefers to use the term “integrated structures” synonymously. This name seems to be justified, because whenever one firm has stakes in another firm we can call this integration (via ownership relation). In addition the term “integrated structures” has the following advantages: (1) It avoids any statement on the organizational form of the new players. (2) It avoids determining any direction of integration, for as will be shown in the paper, the direction of the large groups can be vertical, horizontal or conglomerate and a combination of all three directions.

In mainstream economics built upon neoclassical insights into the Pareto-efficiency qualities of perfectly competitive markets large integrated structures whether horizontal, vertical or conglomerate usually raise concern with regard to competition. They are seen both as a symptom of imperfect competition and a threat to perfect competition and thus for the Pareto welfare optimum of a society. Also with regard to the large groups of companies in Russia’s

agro-food sector the benchmark of perfect competition seems to be at least *implicitly* in the background of some scholar's explanations of the emergence of agroholdings when arguing "that market imperfections ...stimulate over-reliance on vertical and horizontal integration" (Rylko, 2002, p. 50), or "under *working* market conditions family farms might be superior to large-scale farms" (Koester, 2005, p. 111) and "that the creation of new large holdings is not a reflection of *market forces* but of the specific institutional environment" (Koester, 2005, p. 113).

While there is no disagreement about the importance of both the formal and informal institutional setting for the organizational choice the statement that agroholdings are caused by "market *imperfections*" and that they are "*not the result of market forces*" is questionable or at least an oversimplification because it has to be clarified what is meant by "market imperfections" as well as "*working* markets" or "market forces" and what is expected from the latter two to do. In neoclassical welfare economics markets or market forces "work" when they provide a certain outcome, namely prices that equal marginal costs and thus Pareto-optimal allocative and distributive efficiency. For this on markets there must indeed be *perfect* competition with all the well-known Knightian requirements. From the strict assumptions of the perfect market model it also follows that unless for technical reasons like economies of scale and/or scope, integration at the enterprise level can only have the goal to gain market power (Williamson, 1975, p. 82ff.). Since this would harm the social welfare optimum, integration processes are thus viewed as *anti-market* and *anti-competitive*. Yet, to achieve a certain kind of social welfare optimum is not the only goal competitive markets are expected to do (Kirzner, 1997, p. 76). It was the Austrian economist and Nobel Prize winner of 1974, *Friedrich August von Hayek*, who has emphasized that the purposes and the advantages of competitive markets do not lie in it being "perfect", but being a dynamic, rivalrous market process with the function of a discovery procedure (Hayek, 1990, p. 65).

The aim of the paper is to apply this alternative view on competition of Hayek and the so called Austrian School of Economics to assess the development of integrated structures in Russia's agro-food. In this context two questions shall be discussed: (1) To what degree are these integrated structures the result of competition in the Austrian understanding? (2) What impact can be expected from them on competition in the Russian agro-food sector in the future. In order to do so, section 2 explains the Austrian School's understanding of competition and markets in more detail and what consequences this has for assessing the emergence and impact of large integrated business groups. Section 3 applies these theoretical considerations to the integrated structures in Russia's agro-food sector. This is done on the basis of mostly Russian-speaking sources about some of the largest and most publicized agroholdings. The paper ends with concluding remarks (section 4).

2. The Austrian view of market forces and competition

Austrian economists as typified by Ludwig von Mises, Friedrich A. von Hayek and Israel M. Kirzner regard competition not as a state of affairs, which is called "competitive equilibrium" but as a dynamic, rivalrous market process (Hayek, 1948, p. 96) and a "*discovery procedure*" (Hayek, 1968/94, p. 253). It is a process, because markets are seen as made up, during any period of time, of interacting decisions of market participants. Since not all of their decisions may have led to the expected results, because the correspondent market participants might have been either too pessimistic or too optimistic, in the succeeding period of time, decisions will be revised. Competition is regarded as an inherently rivalry and thus competitive process, because each market participant must not only pay careful heed to the prospective decisions of those to whom he hopes to sell or from he hopes to buy, but also to the prospective decisions of (potential) competitors (Kirzner, 1973, p. 12). In fact, according to Kirzner (1973, p. 20), competition can *never* be absent from the market, as long as there is freedom to buy and sell in the market. As a result, even if there is a sole supplier of a certain product, the competi-

tive character of the market process is not affected, because everyone was and is free to offer a better supply.¹

Competition is a discovery procedure that reveals not only profitable products and productions technologies, but also organizational and institutional arrangements and the size and scope of the individual firm (Hayek, 1968/94, p. 249f.; 1990, p. 77f.). The discoveries are made through the experience the market participants make by continually testing their plans in the market (Kirzner, 1973, p. 10). “In each case it is the preliminary outcomes of the market process that inform individuals where it is worthwhile to search... Their attention will be directed by the prices the market offers for various goods and services. They tell them what kind of goods and services are demanded, and how urgently” (Hayek, 1968/94, p. 253f.).

Kirzner (1973) has emphasized, that the driving force in the competitive market process as a discovery procedure is the entrepreneur. The notion “entrepreneur” describes any alert economic agent. This includes individuals as well large, complex business organizations of national or even global scale. Alertness is understood as the discovering of good ideas, inspired by the drive to grasp profit opportunities, i.e. as “noticing the potential for profitable venture” (Kirzner, Sautet, 2006, S. 22). This alert “noticing” may “consist of perceiving a price differential (arbitrage)... In most cases the alert “noticing” consists (in addition to becoming aware of relevant price differentials) of alertly noticing how physical resources can be assembled to generate (physically different) products – for example by the invention of a new technique, in an innovative, profitable manner” (Kirzner, Sautet, 2006, p. 3).²

¹ Also the case of resource monopoly might be considered competitive, if the monopoly control over the unique resource has been acquired by means of entrepreneurial activities. It is argued, that assuming the resource monopolist had no initial assets, anyone else could have also discovered the long perspective opportunity and thus bought the resource (Kirzner, 1973, p. 22).

² If the entrepreneur is the driving force in the market process then the view e.g. of Williamson’s transaction costs economics of markets and enterprises (“the firm”) as being alternative institutions for coordinating transactions in the sense of substitutes is also questionable. Rather than to *supersede* the market, the entrepreneur *uses* the market to reveal profit opportunities (Krüsselberg, 1986, p. 70). Markets and firms must thus be viewed as complementary institutional arrangements. What is very likely to occur when the entrepreneur tries to implement his “good idea” is the replacement of a product market by a factor market. This happens when the good idea consists of producing a certain commodity. For this the entrepreneur concludes contracts with

The outcome of this discovery process is, yet, not predictable, because of the problem of knowledge. Due to limited cognitive abilities the knowledge of human beings in and about complex phenomena like a modern economy based on labour division is limited. Rather the knowledge about the relevant circumstances of place and time on which a single economic agent bases his economic decisions is dispersed among the many people of the society and never given to anyone in its totality, neither to any one of the economic subjects nor to the observing scientists or any omniscient dictator (Hayek, 1945, p. 77f.). It is competition that activates this dispersed knowledge. Competition would in fact be unnecessary if the facts to be discovered like “which goods are scarce, or what things are goods, or how scarce and valuable they are”, are already known or could be predicted (Hayek, 1968/94, p. 253f.). Hayek (1990, p. 69) points out that even the individual operating in the competitive market process does not know in advance how he will act in detail and what particular circumstances he will encounter, so that this circumstances must be still more unknown to anyone else.

If competition and markets are not regarded as a state of affairs, but a dynamic rivalrous process of (entrepreneurial) discovery, than the state of the market, e.g. the number of suppliers of a given commodity or the size and scope of firms (small family farms or large groups of companies), cannot be used as an indication of the level of the working of the market process (Kirzner, Sautet, 2006, p. 19), because the most effective size and scope of the individual firm “is as much one of the unknowns to be discovered by the market process as the prices, quantities or qualities of goods to be produced and sold. There can be no general rule about what is the desirable size since this will depend on the ever-changing technological and economic conditions; and there will always be many changes which will give advantage to enterprises of what on past standards will appear to be an excessive size” (Hayek, 1990, p. 77f.). Also it

input owners that *voluntarily* surrender their rights to use these input to the entrepreneur in exchange for an income. The latter then combines these inputs in the function of an agent to produce a commodity that is then sold in the market (Cheung, 1983, S. 3). As a result transaction costs are economized, because it would now no longer be necessary to make separate payments to each of the many contributing to the production of the respective commodity (Cheung, 1983, p. 9).

is impossible to measure the level of competition on markets trying to determine socially optimal allocation, because the economic agents do not act within a framework of *given* ends and means, of *given* revenue and cost functions, where the allocation problem could be solved by mechanical computation. Rather in the Austrian view the market participants discover the ends which are worth to strive for and which means are available (Kirzner, 1973, p. 33f). “The lowest costs at which a thing can be produced are exactly what we want competition to discover. They are not necessarily known to anyone but to him who has succeeded in discovering them – and even he will often not be aware what it enables him to produce more cheaply than others can” (Hayek, 1990, p. 70).

Markets in the Austrian sense “work” if we can observe a decentralized (entrepreneurial) process of discoveries (Kirzner, Sautet, 2006, S. 22). For this there must be alert economic agents (“entrepreneurs”) that constantly reveal new good ideas to capture overlooked gains from trade and subsequently implement them.³ The possibility to make such discoveries and implementations indeed depends on appropriate institutional conditions (Kirzner, Sautet, 2006, p. 14f). Hayek developed three requirements that these institutions must meet: (1) They shall consist only of prohibitions and not of orders to act in a certain way, because only then is the discovery and use of new knowledge and ways of acting assured (Hayek, 1991, p. 183). (2) There must be no exemptions to rules; instead they must apply to unknown and indefinite number of persons and cases (Hayek, 1986, p. 73). (3) Rules must be valid for a long time, so that the economic agents can build stable expectations (Hayek, 1986, p. 270f.).

Kirzner and Sautet (2006, p. 14ff.) who emphasize the importance of the entrepreneur in the discovering process stress the need for institutions and policies that enable individuals to exercise their creativity to the fullest extent possible. This includes allowing them to reap the gains they have discovered. Consequently, they plead for limited tax burdens and other direct interventions like rent control for they influence profits and thus the incentive for entrepreneur-

³ It shall be noted that the discovery of new ideas is also difficult to measure (Kirzner and Sautet, 2006, p. 19).

rial discovery. In addition the following other institutions are regarded as crucial to make the discovery process possible: (1) Well-defined and enforced property rights so that entrepreneurs have a clear idea of the benefits and costs associated with their activities. (2) The freedom to contract over resources and property rights, since without that many discovered opportunities cannot be exploited. (3) Complete freedom of market entry, because in so far as anyone is free to offer goods and services, entrepreneurial discovery and competition take place.

As obstacles against entry Austrian economists interpret only government protection, e.g. trade barriers, subsidies, certain legal restrictions in enterprise, tax, patent and anti-trust law (Kirzner, 1997, p. 74). Economic barriers of entry that might appear as a result of market foreclosure practices in the course of vertical (and also conglomerate) integration processes like predatory pricing tactics, price discrimination or the refusal to supply are considered to be legitimate business practices, since they are precisely the kinds of entrepreneurial initiative which make up the dynamic competitive process. The same holds for competitive advantages that are due to size like absolute cost advantages or economies of scales or scope that would require from a newcomer a large amount of capital to enter the market (Kirzner, 1973, p. 210f.). Freedom of entry would only then be violated, if someone could raise the necessary capital and met other requirements of being able to compete, such as having assembled the necessary management and workers with the necessary skills, and then was forcibly prevented from entering the market by the government. “The freedom to enter is thus not equal to the ability to enter an industry” (Reisman, 2002). Freedom of entry is thus understood as the absence of privileges, which means that no potential entrepreneur is prevented from exploiting a discovered profit opportunity because of a protectionist limit against imports or because incumbent firms have, through political pressure, succeeded in blocking entry (Kirzner and Sautet, 2006, p.11).

3. Assessment of integrated structures in the Russian agro-food sector

In order to assess the emergence of integrated structures in the Russian agro-food sector and their impact on competition from an Austrian point of view it has to be examined whether there are indications that competition in its function as a dynamic rivalrous market process and a discovery procedure, driven by alert entrepreneurs has been and is at work and if there is evidence that these characteristics might be harmed. This also involves analyzing above all if on the markets where the analyzed largest and most publicized agroholdings operate there are government-induced barriers of entry, because their absence is one of the basic requirements of Austrian economists to induce and ensure the discovery process.

3.1. General patterns of the development of the largest agroholdings

Table 1 presents information about some of the largest agroholdings with regard to the year of foundation, the initiator, the main fields of operation.

Table 1: General characteristics of selected agroholdings

| Company | Year of foundation | Initiator | Main segments of operation |
|---------------------------|--------------------|---|--|
| OGO | 1989 | A.L. Zlochevsky (trading operations) | Feed, flour and oilseed products, bread products, poultry, pork, trade with oil products |
| GK „Agroholding“ | 1992 | A.V. Chetverikov (trade operations) | Feed, poultry, pork, wholesale and retail trade |
| Razgulyay-(Ukrros) | 1992 | I.V. Potapenko (trade operations) | Grain trading, flour, cereals, sugar, poultry and rice |
| ОАО „АПК Орловская Нива“ | 1994 | Oblast administration of Orel | Multiprofile |
| Rusagro | 1995 | V.N. Moshkovich (sugar trading)/ Belgorod Oblast administration (since 2000) | Sugar, grain, oilseeds |
| Agros | 2001 | Interros (V.O. Potanin) (Investment company with stakes in different non-food branches (e.g. Noril'skiy Nikel')) | Grain trading, flour, pasta, poultry and fast frozen food products |
| Wimm-Bill-Dann Foods OJSC | 1992 | Pavel Dudnikov (juice production) | Dairy, beverages (juice, mineral water), baby food |

Source: Own compilation according to Russian journal and internet resources.

Table 2 shows their steps and form of integration.

Table 2: Steps and forms of integration of selected agroholdings

| Company | Steps of integration | Integration forms used |
|---------------------------------|--|--|
| OGO | 1994 Elevators and a bakery 1997 Two poultry plants 1999 Own production of grain and oilseeds 2000 Oilseed processing plants and extension of own agricultural production | Asset relations with great operative freedom for the subsidiaries |
| GK „Agroholding“ | 1994 Production of feed 1996 Entry into poultry production 1999 Entry into pork production 2000 - 2003 Own feed grain growing 2002 Setting up a supermarket chain | Asset relations and contractual arrangements with outside firms |
| Razgulyay-(Ukrros) | 1995 Sugar plant 1999 Entry into grain trading business 2001 3 poultry plants and 1 meat processing plant 2004 Entry in to rice production 2005 Extension of own sugar beat growing | Asset relations with great operative freedom for the subsidiaries Different institutional arrangement with raw material suppliers (spot market, contracts, own farms) |
| OAO „APK Orlovskaya Niva“ | Since 1994 formation of 20 (vertically integrated) agrofirms at the rayon level | Closed production und financial circles |
| Rusagro | 1997 Sugar plant 1998 Entry into own sugar beat growing 1999 Entry into grain and oilseed trading 2000 Oilseed processing plants and integration of 9 farms on the demand of the government of the Belgorod oblast 2002 Integration of another 4 farms 2004 Entry into pig breeding | Asset relations and contracts with independent raw material suppliers and retailers |
| Agros | 2001 Acquisition of the grain trading company “Roshkleboprodukt” 2003 Concentration on the segments pasta, poultry meat and fast frozen food production 2004 Joint venture with Sungrain Holding S.A. of the „Louis Dreyfus Group“ (grain trading) | Contractual arrangements with raw material suppliers and wholesale and retail companies |
| Wimm-Bill-Dann (WBD) Foods OJSC | 1995 Acquisition of Lianovsky Dairy Plant 1996 Acquisition of the Baby Food Plant in Moscow and of further dairy plants 2001 Incorporation of the holding company “WBD Foods” 2003 Entry into mineral water production 2004/5 Acquisition of 4 farms | Asset relations with subsidiaries; contractual arrangements with input suppliers and retailers; mostly long-term contracts with raw milk suppliers (except for 4 farms) |

Source: Own compilation.

From this comparison the following patterns can be observed:

- (1) Except for “Orlovskaya Niva” the largest agroholdings were created from below by private businessmen who mostly stem from (agricultural) commodity trading.
- (2) The start of most of the analyzed agroholdings goes back to the first half of the 1990s. They have then evolved slowly over several years.
- (3) These are engaged for the most part in crop commodity segments. In livestock production they are involved only in poultry as well as in recent years also more and more in pork production. An exception is Will-Bill-Dann, which from the very beginning concentrated on high value-added food products.
- (4) The direction of integration is often at the same time horizontal, vertical and conglomerate. It is horizontal, since most agroholdings have bought several enterprises in the fields of processing, trading, and sometimes also in primary agriculture. It is vertical, because usually they comprise at least two stages of the vertical production chain (e.g. “Agros”). Finally, it can be called conglomerate, for even if the initiator is not from a totally unrelated field to agro-food production, agroholdings operate in different food product fields, although they are often closely related.
- (5) With the exception of “Orlovskaya Niva” agroholdings entered agricultural production at a relatively late stage of their development, mostly after 1998. A particular strong engagement in agriculture can be observed at “Rusagro” from the year 2000 on.
- (6) The extent and degree of vertical integration along the supply chain differs not only between the different agroholdings but also within the companies depending on the sector in which they operate. While “Agros” integrates only storing and processing “Orlovskaya Niva” covers the whole production chain.
- (7) Often the agroholdings apply various institutional arrangements to secure agricultural raw material supply. For example, the group “Razgulyay” uses at the same the spot market, con-

tractual arrangements and own production, trying to balance the advantages and disadvantages of each method. While “Razgulyay” hardly uses own production of agricultural products in its grain segment, in the sugar segment its importance is growing. This is on the one hand due to bad experiences made with contractual arrangements. In some cases sugar beet producers did not produce good enough quality although the main company provided them with modern technologies, in other cases farmers did not pay back the credits given to them by the main company to buy inputs. On the other hand “Razgulyay” suffers excess capacities in its sugar processing plants after massive acquisitions in the last years. Growing its own sugar beet is intended to improve capacity utilisation.

In the following we will take a closer look on these developments and distinguish between agroholdings that have been created from below and those that were state initiated.

3.2. Agroholdings created from below

That competition in its function as a discovery procedure driven by alert entrepreneurs seems to be working can be concluded from the fact that except for “Orlovskaya Niva” where the state is the initiator of integration, the integrated structures developed over a period of many years in a trial-and-error process responding to perceived profit opportunities under the specific institutional and economic environment of Russia’s transition economy. These profit opportunities laid at the beginning almost exclusively in the crop sector and later also in the poultry and pork business. In contrast to that in a long time unstable institutional and economic environment like in Russia stock farming is unattractive for investors due to its long investment return cycles. In the poultry business, but also in the pork business the breeding cycle is shorter and hence investments less risky. Taking into account that Russia’s formal institutions have long been far from functioning perfectly (see e.g. World Bank, 2005), coordinating transactions using not exclusively spot markets but also more complex contractual and organizational arrangements is a rational business decision (see also Hockmann et al.,

2003). Empirical studies on vertical and conglomerate integrated business groups in emerging markets in Asia or Latin America support this view (Khanna, Palepu, 2000; Kali, 2003, p. 690).

Another evidence showing that agroholdings seem to be a result of competition as a discovery procedure is that many of the largest firms have been continuously changing their organizational structure. Wimm-Bill-Dann consolidated the group in 2000-2001 which led to the creation of a holding company. “OGO”, “GK ‘Agroholding’” or “Razgulyay” have introduced subholdings for different product fields. The delegation of more competences to specialised tiers of the hierarchy serves to reduce the likelihood of entrepreneurial mistakes as more diversified activities are put together. In addition, with this step transparency of the integrated enterprise for outside investors, especially on the stock markets, shall be increased. This was the explicit purpose WBD’s, OGO’s and Razgulyay’s reorganization. All have meanwhile issued bonds and IPO on the national and international financial markets.

Another indication that competition so far fulfils its function in the Austrian sense is the fact that some big agroholdings came to suffer losses and started to sell off plants (Kostina, 2003; Sagdiev, 2003). In 2004, the group “Rusagrocapital” that was founded in 1999 and controlled about 20 grain processing and storage companies and animal feed plants even went bankrupt. Already in 2000, “Razgulyay” has started to narrow its fields of operation on two main fields – sugar and grain. In 2003, the founder of GK “Agroholding”, Aleksandr V. Chetverikov, announced to draw back from its engagement in primary agricultural production. In August 2005, “Rusagro” exchanged sugar companies with “Prodimeks” in the Belgorod and Voronezh oblasts and in September 2005 “Rusagro” sold most of its grain business to the American grain trading company “Cargill”. In the same year, OGO sold three oilseed processing enterprises (Osipov, 2006). Aleksey Yazykov from the investment company “ATON” suggests that the big agroholdings will in the near future withdraw from vertical integration at all and concentrate on horizontal integration (Filatova, 2004).

Nevertheless there are also developments that must raise concern from an Austrian point of view. These are the close relations of some of the agroholdings created from below with regional politics that might lead to government protected barriers of entry and thus hamper competition in its function as a discovery procedure. This holds especially for the GK “Agroholding” in the oblast Kursk. In July 2002, the founder of the “Agroholding”, Chetverikov, and the governor of the Kursk oblast have signed an investment agreement for a period of ten years. In exchange for the obligation to support the regional governments’ plans to develop pork production in the oblast, the “Agroholding” was allowed to take over two big bankrupt pork complexes. The government even promised to provide access to subsidized credits and tax relieves (Kulagina, 2002). This pattern of interaction between important enterprises and the regional government is not uncommon in Russia. In exchange for political support big enterprise are used as agents of the government to solve economic and social problems, for which they are provided with favourable economic conditions (Khramova, 2002, p. 127; Ortung, 2003, p. 3ff.). This interconnection between economic agents and political decision-makers can be interpreted with Hedlund (2005, p. 306) as a path dependency of the patrimonial legacy that has its roots not in the Soviet era but in Moscovite times. Besides this cooperation with the regional government, Chetverikov himself has been active in politics. In 1999 he was elected to the Russian State Duma and became member of its agrarian committee. He is said to have been a major player lobbying for the temporary ban of US chicken meat to Russia and after that kept on demanding more government support for the Russian agro-food sector (http://www.agroholding.ru/News/news_136.sht).

Similar is the situation with the group “Razgulyay“. In 2004 it started together with the government of the Kray Krasnodar the so called “Kuban-Rice-Project”, which resulted in the formation of a common subholding for rice producing and processing enterprises, the OOO “Kuban-Ris”. Today “Razgulyay” actively demands the introduction of tariff quotas for the import of rice (Konkin, 2005). Note, that in Krasnodar almost 90 % of all Russian rice is pro-

duced. If this demand for protection was fulfilled, Razgulyay could indeed become a monopolist in Russia's rice production. Since this position would not have been reached through superior entrepreneurial skills but through the support and protection from the regional and federal governments, such a situation would be considered problematic from the perspective of Austrian economics.

3.3. State-initiated agroholdings

Even more problematic in this regard are those agroholdings that were directly founded by the state or at least encouraged. From the examples of table 1 and 2 Orlovskaya Niva from the Orel Oblast is state founded, while Rusagro from the Belgorod Oblast can be considered as state encouraged at least concerning its engagement in agriculture. As a result of the regional governments' active role, agroholdings control a large share of farmland in these oblasts which is considerably higher than in any other region where agroholdings exist. According to Petrikov (2005, p. 28) in the Belgorod oblast agroholdings controlled in 2004 almost 56 % of the region's agricultural land. In Orel, only two very large holdings control 350,000 ha, respectively 338.000 ha which is about one third of the oblast's total farmland. There the government favoured integrated structure in order to better regulate the region's agro-food sector. With the help of state controlled integrated structures it is tried to restore the so called „price parity“, meaning that input prices for farmers should not rise faster than output prices. In order to realize this purpose in Orel the whole agro-food sector of the oblast was organized as a hierarchical structure. At rayon level so called agrofirms were founded where all entities of a certain vertical production chain merge into one single integrated enterprise. The majority of the shares of the agrofirms are usually held by the rayon administration. The activities of the agrofirms are controlled and coordinated by two big holding companies that are owned by the oblast government. The first of these oblast holdings - the open joint-stock company OAO

“Orlovkaya Niva” - was founded already in 1994, the second - OAO “Orlovskiy agrokombinat” - in 1999.

In the Belgorod Oblast integrated structures were promoted by the governor in order to reorganize insolvent agricultural enterprises (Rodionova, 2001, p. 38). This goal was also explicitly expressed in the regulation of the oblast administration of the Oblast Belgorod No. 710 of 14.12.1999 “On measures to restructure insolvent farms of the Oblast”. In order to avoid the massive bankruptcy of farms, the resolution recommends insolvent farms to join well developing industrial, agricultural, processing and other organisations, that have significant own financial resources or good access to credits. After the passing of this resolution integrated structures in the form of agroholdings began to emerge in a great number in the Belgorod Oblast (Ushashev, 2002, p. 6).

Officially, the decision to join an agroholding is voluntary. In reality, however, the regional government can exercise pressure on insolvent farms to take this step. This is because the government is often their major creditor due to outstanding tax payments to the regional or local budget. In addition, the regional government has the power to decide which farms are eligible for subsidised credits.⁴ With regard to the investors the question is how they are encouraged to take over insolvent farms. Rusagro states on its homepage that the inclusion of agricultural enterprises was done “on the demand of government of Belgorod” (Rusagro, 2006). An analysis of Russian internet resources on the company gives reason to believe that several privileges like tax breaks or easier access to credits were used to attract them (see e.g. Sagdiev, 2003b; Krest’janskije vedomosti, 2004). For example, the company has concluded an agreement with the government to carry out as the leading agent the oblast government’s program of 2003 on the development of the pork production for the region. For this the oblast government provides tax breaks and subsidized credits. In June 2005 this agreement has been

⁴ The system of subsidized credits was introduced in 2001. Commercial banks are to provide these credits to farms but the state compensate two thirds of the interest rate.

criticized as anticompetitive by the Federal Antimonopoly Committee, because these privileges were selectively granted only to Rusagro (Press-Slushba FAS, 2005). Austrian economists would welcome this decision because the policy of the Belgorod government creates privileges and thus non-economic barriers of entry and thus prevents the development of competition as a discovery procedure and a dynamic rivalrous process.

Similar is the assessment of the agroholdings in Orel. In this oblast it is even more evident that the integrated structures are not the result of competition as an entrepreneurial discovery procedure but the result of “pretence of knowledge” (Hayek, 1974/96), because the oblast government established and owns the two big agroholdings itself, claiming to know what institutional arrangement serves best the interests of the regional agro-food sector. Here, too, we find reports of anticompetitive behaviour of the two state-owned agroholdings. Especially Orlovskaya Niva was criticized for charging too high prices for farm inputs. This seems to indicate that the management of the oblast holdings abused their state protected oligopsonistic power to maximize their own profits instead of supporting their subordinated agrofirms. Also, due to the state regulation of farm-gate prices food products produced by the processors in Orel are more expensive than in the neighbouring oblasts (IET, 2001, p. 29f.; Rodionova, 2002, p. 176). According to Austrian economics in the absence of governmental entry barriers these high prices would induce newcomers. However, since the oblast government tries to prevent the free flow of food products with other regions (see e.g. the Resolution of the Governor No. 364 of 09.08.1999) the basic requirement of Austrian economists to create and ensure a dynamic and rivalrous process is not fulfilled in this region, either.

The direct establishment of integrated structures in Orel by the regional government and the indirect encouragement of such arrangements in Belgorod can be explained by Douglass North’s theory of the path dependency of institutional change (1992, 1994) or what Williamson (2000) called embedded institutions. Both point to the importance of prevailing mental models of economic agents and political decision makers that have been shaped by the past

and determine their institutional choices today. With regard to the promotion of vertical integration processes these path dependencies are supposed to be the belief in the importance of price parity and the comparative advantage of closed vertical production cycles (Wandel, 2005, p. 36) as well as the conviction of regional policy-makers to have the responsibility to keep alive agro-food enterprises for social and food security reasons (see also Koester, 2005, p. 109). Path dependency seems to be particularly striking in Orel, because integration there resembles very much the forms of vertical integration, which were developed for the Soviet agro-industrial complex in the 1980s (Hockmann et al., 2003. p.1248f.).

A recent appraisal of the agroholdings in Orel and Belgorod of Petrikov (2005, p. 30f) shows that these structures do not seem to be sustainable. In Orel they make losses and are not able to pay the salary to their employees on time. The agrofirms are highly indebted vis-à-vis their holding companies, for they, too, do not make enough profits to pay back loans (see also Regnum, 2004). In Belgorod, Petrikov (2005, p. 30f) has found out that non-integrated firms show much better financial results than integrated ones. This might be an indication that competition as a discovery procedure may become at work in these regions, too, because continuing losses should be an incentive for changes.

4. Concluding Remarks

The paper tried to assess the development of agroholdings and their impact on competition in the Russian agro-food sector from the point of view of the Austrian School of Economics. As often in Russia, a clear cut conclusion is not possible, since there are different regional developments. It has been shown that for those large agroholdings, that emerged in an evolutionary manner, the Austrian view of competition as a discovery procedure seems to have been and still to be at work. In the Orel and Belgorod oblasts, however, there is much evidence that the integrated structures appeared not as result of a discovery process but of political decisions.

The fact, that the economic situation of these integrated structures has worsened, gives reason to expect that competition as a discovery procedure may become at work there, too, at least in the long-run. It can, however, not be excluded that there will be instead a call for more protection and subsidies. If a region is able to provide that, depends on its financial resources. Since according to Ivashina (2005, S. 67) Orel belongs to one of the greatest debtors to the federal budget these possibilities seems to be limited. On the other hand the federal agricultural policy itself is following more and more an interventionist course. The most recent step in this direction was the passing of the National Priority Project in 2005 which provides state support for investments into livestock production (Serova, Shik, 2006, p. 35ff.). From an Austrian point of view such a program must be considered as pretence of knowledge, since profitable investment opportunities are not detected with the help of competition as a discovery procedure but with government set incentives.

How such policies come into being and what role big integrated structure may have played or still play is an interesting topic for further research that goes beyond the scope of this paper. The case of the GK “Agroholding”, where the owner was also an active politician, showed that powerful integrated structures, might indeed wield their political influences to attain such policies. This in turn preserves and expands the resources at their disposal for further political lobbying for protection and compensation from outside competition (Morck et al, 2005, p. 693ff.). Austrian economists are well aware of the danger that powerful business groups can exercise pressure on politicians to get protection. However, they don’t see the solution to this problem in prohibiting integration, for this would be pretence of knowledge and deter entrepreneurial activities. Rather, they favour to find institutional arrangements that prevent *politicians* to give in rent-seeking activities of incumbent economic agents (Hayek, 1990, p. 20ff. and 104ff.). The discussion how this could be possible also goes beyond the topic of this paper (see e.g. Streit, 2005, p. 118). In the end result every society has to decide itself, if and how it wants to react to the integration processes. The only thing economists can do is, to

show that there are several theoretical concepts and what their advantages and disadvantages are.

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