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Industrial complexes and global financial risks

This report is devoted to preliminary appraisal of contemporary processes in world financial markets that influence the main subject of geography of industry: the forms of spatial location of industrial activity.

One of the most prominent events in Soviet spatial planning was the creation of so-called Territorial Production Complexes (TPC), mainly in Siberian resource regions with low development (1, 3). They were based on the sources of abundant natural resources and designated to produce industrial goods of primary processing. The base of their development was the abundant source of power – usually a hydroelectric station or a coal basin. These complexes gave appreciable results of economies of scale and other savings due to the combined use of land and infrastructure by interconnected enterprises. It was a rather effective way to withstand the prevailing sectoral planning and management of the industry in the ex-USSR.

However, this type of spatial organization of industry was subjected to substantial trials in the transitional period. It had started to be regarded as a form of allocation of the industry only for state-planned economy that cannot be developed under market conditions, although the TPCs were grounded on universal principles of transportation costs optimization inherent in any large corporation in a market economy based on “external economies”. During the period of privatization the key enterprises of TPCs were transferred to large financial-production groups and had reoriented their sales from domestic to external markets. They had undergone reorganizations and began to function in new chains of production that strengthened their semi-productional specialization.

It was effective enough from the corporative point of view, but most of these industries ceased to be the base for regional development. Their structure was simplified, since they transformed into outlying suppliers of raw materials and intermediate goods, the effect of multiplication for the surrounding area became negligible, and most importantly – the taxes on their profits went to centres of their headquarters, that is to Moscow, and later also to Sankt Petersburg and to the offshore sector. The state policy was aimed to create and develop, in a short run, large national and transnational corporations competitive in external markets.

A constantly increasing gap in development among different parts of the country, and the obvious backwardness of welfare in export-oriented regions (except for oil-extracting areas) demanded new ways to be looked for in order to solve this problem. The ideas of industrial complex development led to drawing a parallel line with clusters, especially “regional clusters”, and looking for prospects of their co-existence (4–6). The regional authorities even tried to plan and organize such clusters, for example in wood processing or food production,

but absence of a real antitrust policy blocked the growth of small and medium-size businesses in principal regional industries that could support development of local communities. Some authors include institutions into the very definition of clusters, so we can underline the main reason for the failure of these projects: the lack of institutions for clustering in industrial areas.

The other point of view is based on the negative effect of continentality of Siberia, so the problems of competitiveness are explained by its remoteness from world markets and can be overcome by widening the state interference in the economy (4).

In reality this task was not vital for regional economies in the period of high prices of minerals, fuels, aluminum and other products in external markets, and especially in adjacent growing China. The resource corporations and their capitals were regarded as the framework of regional economy and a guarantee of its stability. The state regional policy returned to the TPC principles and began to implement the so-called "new wave of industrialization" in Eastern Siberia, with state-private cooperation. In fact, it is a restoring of TPC system establishment in Siberia, for example the initial and principal object of this industrialization is the construction of Boguchan hydroelectric station in the lower Angara, which was started in the late soviet years (2).

The other objects included pulp and paper enterprises, aluminum plant and other auxiliary activities including infrastructure. This complex called Project of Lower Priangarje is located in Krasnojarsk Region. The strip of new industrial construction is planned to be stretched to the eastern regions. In Irkutsk oblast the additional aluminum plant is projected, the oil pipeline to the Pacific Ocean is under construction and reconstruction of basic enterprises (pulp and aluminum production) is also declared. A network of local pipelines and energy lines will cover adjacent areas of Buryatia and Sakha-Jakutia.

We can now talk about the next period of testing of these approaches to regional development, related to the global financial crisis. The first signs of recession manifested themselves in delays and stoppage of payments by these large corporations and business groups that are spread along the chains to other sectors of the regional industrial complex with a poorly developed system of local activities.

The decline in world prices of aluminum and pulp led to the overfilling of warehouses and the plants stopped production. Thousands of people in Bratsk, for example, have not got wages for the last two or three months.

But this is explained not only by fluctuations and declines of world market prices. These are large corporations that formed the channels of crisis influence on the resource economy of Siberian regions and contributed to their instability. That fact has been recognized by regional authorities. The unprecedented accumulation of capital for expansion and "new industrialization" has been achieved by active drawings from international finance markets of stocks of securities and with the support of the State. Now these stocks have lost their value and one of the richest and powerful corporations in Russia, the possessor of the aluminum and hydroelectric plants in Eastern Siberia and the principal investor of the project of the Lower Priangarje, the "Basic Element" Co. headed by Oleg Deripaska, experiences a situation of margin-call, when it is not able to meet its obligations to international creditors without the State support. Additionally, the famous Pulp and Paper Plant at the Lake Baikal shore, which has caused irritation and protests of ecologists almost since the time of its setting in operation, has been closed just now and, naturally, not for ecological, but for the financial reasons. This plant has also been bought by Deripaska's company "Continental

Management. In fact, the corporation has given up this plant, which is a major employer also in the Baykalsk town area.

These global financial risks reflect an imperfection of existing institutions in the areas with large industrial complexes. We think that the coming crisis will lead to revision of the forms of organization of the industry in areas dominated by natural monopolies. But we cannot say whether it will lead to return to the clustering approach and development of alternative activities related to processing production and innovations in these areas. The prevailing trends in the Russian economy show a great probability of partial renationalization of the principal enterprises of industrial complexes, with strengthening of the ideology remaining in the society in the background. The ideas of continentality and remoteness of Siberia from the main economic centres will also be claimed for supporting the control of state corporations over the principal enterprises. It can be implemented through an increase of the state share in problem firms. So another phase of TPC development is expected. Anyway, the plans of new wave of industrialization are doubtful in crisis conditions.

The progress of this stage depends on the situation in world markets, but effectiveness of post-crisis functioning will be lower than before, due to social obligations and dependency on external factors. State corporations function also as competitors in internal and world markets, and have no incentives to develop local industrial environment as it was designated in the Soviet period. This coming stage must evidently show the declining ability of these complexes to support regional development.

A new type of economy will arise out of this sector. In the post-crisis period, the traditional appeal for external investments must be changed to the policy of increasing internal investment sources. There is a need to return again to ideas of small and medium businesses, not as additional sources of income but as the strategic investment potential. The process of initial accumulation of capital and development of local industrial relationships and networks that was deformed in the transitional period by financial corporations will take place in new conditions.

So the crisis offers an opportunity to stop the development of Holland disease or overcome the path dependency, but not immediately. And this period will be more painful for the regional society than in areas with developed consumer economy and social networks, because only steady unemployment is the strongest argument for a change of institutional environment.

The background for new forms of spatial organization is formed by existing clusters that have been developed beyond the state and corporate interest – that is e.g. communications and tourism. And if the first mentioned branch, the communications, has been later integrated into external networks, the second one, tourism, is steadily developed by means of the regional investment potential.

The industrial sphere of regional development of that kind includes wood and mineral processing, consumer production and other activities that are inherent to areas with developed local and regional economy. The post-crisis development of plants of former TPC with primary processing will lead to their restructuring for achieving a new level of productivity. A sharp decline in numbers of employees on these enterprises is the only way to decrease the dependency of local societies on their existence. The former industrial complexes will cease to impede development of the regional economy and will become a normal part of it that works for internal and world markets, irrespective of proprietors of these enterprises and sources of their capital.

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