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A tale of two city-states: Novgorod and Pskov in the 1990s

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All opinions expressed are those of the authors and do not necessarily reflect the views of the Bank of Finland.

Laura Solanko - Merja Tekoniemi*

A Tale of Two City-States; Novgorod and Pskov in the 1990s

Abstract

This paper examines two regions of the Russian Federation, Novgorod and Pskov, to compare how differences in economic policy affect economic development. Despite common histories, geography and natural resources, Novgorod committed early on to policies that would attract foreign investments in production. Pskov, on the other hand, withdrew into protectionist policies until it was clear that efforts to increase domestic and foreign investment levels were needed. Using available statistics, we consider the reasoning that led these regions down such distinctly different economic policy paths – and consequences of these choices.

Keywords: Russia, regions, Novgorod, Pskov

1 Introduction

When the transition processes of former Soviet Union (FSU) countries began, most experts stressed fast economic reforms as a means to achieve high growth rates. Lately, however, the stress has shifted to establishing sound institutional bases and rule of law as preconditions for sustainable economic growth. Simultaneously, as more data has become available, several empirical works on growth and the determinants of growth in transition countries have been published (e.g. Sahay et al 1999, Havrylyshyn et al 1998, Melo et al 1997). Much of this literature points to the pre-eminence of structural reforms over initial conditions and macroeconomic policy in determining a country's growth performance.

Due to data restrictions, little empirical research of this nature has been done on Russia's regions. The most recent paper of which we are aware is Ahrend (2000). Using a panel data on all Russian regions except autonomous *okrugs*, Ahrend concludes that initial conditions largely explain regional economic performance. Given the huge variations in initial conditions across Russian regions, this result is not entirely surprising. Van Selm (1998) also concluded that policy did not explain regional differences in economic performance in 1992-1995. On the other hand, Berkowitz and DeJong (1999), on the basis of panel data for 1993-1996, conclude that regional policies do matter. They find a clear relationship between growth and new enterprise formation, the latter being influenced by regional policies.¹

In this paper we seek to discern whether regional policies actually matter by examining a tiny case study of two rather similar small regions (*oblasti*) in the Russian Northwest: Novgorod and Pskov. Apart from being close to Finland, the main reason for focusing on these two is their similarity in the initial conditions for economic reform: history, geography, population, natural resources – and to a lesser degree, the inherited industrial structure. Novgorod was once a major military-industrial centre of northwestern Russia, whereas Pskov was more inclined towards agriculture and light industries. Nevertheless, both regions suffered large declines in industrial production in the 1990s. From Moscow's point of view, both Novgorod and Pskov are small, poor, and lack the prerequisites for rapid economic growth. Nevertheless, Novgorod has outperformed Pskov economically. It has succeeded in attracting large flows of new investments, especially foreign green field investments. Pskov's economy, on the other hand, declined much faster than the Russian average

in the early 1990s. Thus, this pair provides interesting contrasts in analysing the scope of regional economic policy in determining economic performance.² Defining quantitative indicators characterising regional economic policy is troublesome at best, and thus we believe that restricting our comparison to the relative economic performance and policy of just two regions alleviates some of the data problems inherent in these kind of studies.

Apart from differences in the inherited industrial structure, another factor that seems to be important in explaining the difference between the performance of these regions is economic policy. Novgorod committed early on to reform-minded policies that would attract foreign investment, while Pskov retreated into protectionist policies. The level of foreign direct investments may be an especially valuable indicator of regional economic policy. Foreign investors in particular make location decisions not only on the basis of the availability of resources and proximity of large markets such as St. Petersburg and Moscow, but also on their perceptions of the attitudes and predictability of the regional administration. The Novgorod region has been analysed in numerous case studies and labelled e.g. as “the Russian success story” by Petro (1999) or the “champion of liberal economic reform” by Ruble-Popson (1998). On the other hand, Zimine-Bradshaw (1999) rightly point out that, despite attracting large FDI inflows, Novgorod still is a relatively poor region and not an outstanding economic success even for the Russian Northwest. The Pskov region, on the other hand, established a reputation for its Soviet-style economic management, analysed by e.g. Slider (1999), and for its proximity to the national border with the Baltics, described by Alexeev-Vagin (1999).

The second question we find interesting is whether Russian regions tend to imitate their better performing neighbours. Earlier literature on regional competition usually concluded that competition was welfare-deteriorating, but recently there has been discussion on whether in a transition economy competition and imitation might be actually a benefit, e.g. Qian-Roland (1999).

Russian regions have had considerable freedom – at least up to now – in determining economic policy in their jurisdiction. Some have retained a large degree of price controls and state ownership, while others have attracted investments with hefty tax breaks and other benefits. Assuming that regional policy choices have at least some influence on economic performance, it is natural to assume that in the medium and long run poorly performing regions eventually have to adapt their policies. Regional experimentation and imitation has often been pointed out as one of the factors behind China’s economic

success. If the same processes are to be found also in Russia, the wide variety of occasionally conflicting regional economic policies may not be completely harmful for the federation as a whole.

We are not aware of other papers focusing on possible imitation of regional economic policies in Russia, and we readily admit the data problems connected with this type of assessments. Still, in our opinion, the issue is important enough to warrant study. Here analysing similar regions with pronouncedly different economic policies should be especially interesting. Moreover, it appears economic policy in Pskov is on the cusp of change as it has become clear that efforts to increase investment levels are needed.

Much of the basic information for this paper was gathered during our short visit to these regions in 1998. In updating and redefining our 1998 work we have not had the possibility to return, so it is fortunate that the regional administrations and local press provide an abundance of valuable information on their Web pages. We also make extensive use of Goskomstat data, well aware that their reliability has been seriously questioned e.g. by Hanson and Bradshaw (2000). The next section describes the initial conditions of these regions and section three examines their economic policies and performance in the 1990s. Section four offers some preliminary conclusions and discusses possibilities for future research.

2 Similar resources

As noted in the introduction, Novgorod and Pskov are very similar. The history of these ancient city-states differs from most other Russian regions. Both Novgorod and Pskov remained independent city-states during the Mongol invasion, and contrary to the rest of the country, retained a degree of democracy in their administration. Novgorod was headed by elected princes and assemblies of freemen (*veches*) that decided on e.g. declarations of war or peace. These traditions were replaced with the supremacy of Moscow when Ivan the Terrible annexed the Novgorodian and Pskovian lands. However, the myth of a glorious past prior to the arrival of Muscovites has become a useful means, especially in Novgorod, to underline commitment to reform and the distance from the corrupt and sometimes authoritarian practices of present-day Moscow. For more discussion of the connection of history and present-day Novgorodian politics, see e.g. Petro (1999).

After the WW II, massive reconstruction began in both regions. Industries such as radio electronics, optics and chemical production were centralised in Novgorod, making it a large military-industrial hub in northwestern Russia. The disintegration of the Soviet Union in 1991 and the re-establishing of frontiers between Russia and the Baltic states changed the strategic position of Pskov, in particular. It became, once again, Russia's outpost against the West and was accorded a greater military significance. The change also saw temporary cutting of cooperation ties with Belarus and the Baltic states.³

Given the huge regional variation in Russia, these two regions are also rather similar in their initial conditions for economic reform. Both regions have populations of less than one million living on land area of 55,300 sq. km. Thus, both are extremely small economic units by any criteria; a fact further enhanced by the lack of valuable natural resources other than wood. High-quality clay, sand, peat, limestone and gravel are extracted in both regions. The Pskov region has gypsum deposits, and the Novgorod region has natural springs with mineral water. Russia's natural resource endowments have played an important role in regional economies. As raw materials are rather easy to export, some resource-rich regions had a possibility to benefit from the price difference of world market prices and internal prices for oil, gas, certain metals, etc. Neither of the regions in question here had this advantage.

Both Novgorod and Pskov are ethnically homogenous, which is probably a benefit in planning coherent regional economic policy. On the other hand, like most of normal Russian *oblasti*, Novgorod and Pskov could not use the nationalistic card in trading for benefits from the centre. After the disintegration of the Soviet Union, Pskov has had a larger influx of "refugees" from other CIS countries than Novgorod. Even so, the populations in both regions have gradually declined throughout the 1990s. The urbanisation rate in early 1990s was close to 70 % in both regions, slightly less than the national average. Several Goskomstat-based social indicators such as the ratio of doctors or hospital beds per thousand inhabitants were roughly the same in both regions in 1985 and again in 1990. Goskomstat data on value of retail sales in 1985, 1990 and 1991 is similar for both regions, although monthly wage data indicate slightly higher wages in Novgorod during the period. Novgorod may nowadays be slightly better positioned in providing higher level education, but initially neither Novgorod nor Pskov had a university. Novgorod State University was established in 1993 when the pedagogical and technical institutes joined. A small private university was established in Pskov only in 1995.

Novgorod lies along the main highway between St. Petersburg and Moscow, a slight logistical advantage. The transportation network as measured by Goskomstat statistics on railway and highway density in 1985 and 1990 is similar for both regions. (See Table 1 in the appendix for a summary of basic indicators.) Pskov, on the other hand has found its position on the re-established state border somewhat uncertain and the region clearly has not been able to promote its position as a possible gateway between Russia and the Baltics.⁴ A considerable share of Russian transfer shipments to Estonia and Latvia (mainly oil) are shipped via the Pskov region, but as export duties are under federal jurisdiction, the Pskov region has not benefited from this trade. During the last couple of years, however, with establishment of new border crossings and increased cooperation with the Estonians, the border region has begun to be seen as a possibility as well as a threat. (Alexeev-Vagin, 1999). At least in theory, Pskov should be able to benefit from its location at the border with Estonia, Latvia and Belarus – especially if the two Baltic countries join the EU. However, the examples of other Russian border regions indicate that they may tend to be even more inward-looking and protectionist than Russian regions in average.⁵

Although they share a common history and geography with rather similar resources and social conditions, Novgorod and Pskov differed in their economic structures at the start of transition. The different industrial structures reflect economic structures inherited from the Soviet era. Pskov was once a relatively important producer and refiner of agricultural products, with a significant share of machine building and light industry such as clothing. Much of chemical and radio technology industries serving the military industry were centralised in Novgorod.

Consequently, two notable differences in the initial economic structure were the relative size of agriculture and the structure of industrial production. Agricultural production was and has remained far more important for Pskov than Novgorod (see Tables 3 and 4 in the appendix). The greatest differences are in the initial shares of chemical industry, machine construction and food processing. In 1995, nearly 70 % of industrial production in Pskov was machine construction and food processing. In 1997, the same branches of industry still produced approximately 55 % of Pskov's total industrial output while electricity generation amounted to 25 % of industrial production. The industrial structure in Novgorod was somewhat more diversified as the two largest branches, chemical and wood processing, amounted to less than 50 % of total

industrial production in 1995 and 1997 – and presumably also in early 1990s (see Tables 7-8).

Light industry and machine building were hit particularly hard everywhere in Russia after liberalisation of prices and foreign trade in early 1990s. According to Goskomstat, production volumes in these branches (e.g. textiles, shoes and refrigerators) started to decline in 1992, with the single largest drop experienced in 1993-1994. A similar pattern of production decline is confirmed also in Novgorod and Pskov. In Novgorod, production of consumer electronics such as TV sets and radios were not competitive enough when foreign trade was liberalised while Pskov produced e.g. garments, household appliances and transport devices. However, the share of these two branches in the total production was much larger in Pskov. A drastic drop in production volumes occurred only after 1993 in both regions but Pskov clearly experienced a more dramatic decline. Compared to 1990, the 1995 output level in light industry was down by 75 %, machine building by 70 % and the food industry by 45 % (Pskovoblkostat). While the drop in light and food industries was even larger in Novgorod, it was partly offset by a smaller decrease in other industries.

Thus, despite a starting level similar in terms of the resource base and economic development, the transition experience of both these regions has been markedly different. In 1990, the value of total industrial production was almost equal in both regions. In Pskov, the total industrial production declined more rapidly in 1990-1996 than in Novgorod and in Russia on average. In 1996, the volume of total industrial production in Pskov was only a quarter of the level six years previously whereas the corresponding figure for Novgorod was approximately 50 %. Thus, it seems that due to its industrial structure Novgorod was slightly better equipped to face the economic recession in the early 1990s. Although army procurement has dried up in recent years, the relatively high-tech industrial enterprises in Novgorod found it easier to move to other lines of production than hard-hit light industry enterprises.⁶ The best example is the Novgorod chemicals industry (mostly fertilisers), which has succeeded in retaining its output at levels comparable to 1991 levels (Zimine-Bradshaw 1999, p 337).

Both regions, like most northwestern regions in Russia, receive aid from the Federal Fund for Financial Support. Novgorod, however, is economically stronger than its neighbour and less dependent on federal aid. In 1994-1996, federal aid comprised 28 % of the region's budgetary income, which is never-

theless significantly higher than the average for all regions (14.3 % in 1996). In Pskov, federal aid comprised 38.2 % of the budgetary income in 1994-1996. In 1996, income transfers accounted for as much as 43 % of Pskov's budgetary income. Novgorod has been more efficient in collecting revenues, even though its economic reform strategy has been based on granting significant tax relief for new investment from the very beginning. In the same three-year period, tax revenues per capita in Novgorod were 60 % of the federal average compared to about 45 % in Pskov. If federal income transfers decrease as economic power is recentralised, the Pskov region may face graver difficulties than Novgorod.

To sum up, both of the small, poor regions lack significant economic resources. They differ in their industrial structure and the role of agriculture, but are still fairly similar on nation-wide scale. Both experienced a large drop in total production in 1992-1994, with the less dramatic drop in Novgorod. In both regions agriculture is still important.

3 Differing political orientations and economic policies

Pskov's early economic reforms reflect a lack of reform-minded, visionary leaders. In 1996, in order to attract investments to the region, the Pskov legislature passed an act guaranteeing similar terms of investments to foreign investors as those enjoyed by domestic investors. By that time, the administration had also begun to establish relations with foreign countries and actively seek to attract investments by various tax incentives. Governor Vladislav Tumanov's⁷ actions for attracting investments were considerably more cautious than the campaigns of the Novgorod administration. Nevertheless, he is credited for reforming the local administration. Local elections were held in February 1996 and towns and regions were allowed to keep a considerable part of the tax revenues collected within their jurisdiction. Nevertheless, Tumanov, who was backed by the national power elite and also by Yuri Luzhkov and Vladimir Yakovlev, lost the gubernatorial election in November 1996 to Yevgeny Mikhailov, 33, of Zhirinovskiy's LDPR fraction. The high turnout percentage in the second round of the elections (60.2%) gave cause to presume that there were a significant number of protest votes. The change of governor certainly did not promote new domestic and foreign investments (Slider 1999).

The fact that a relatively liberal, reform-minded governor has been voted out of office is no rarity in post-Soviet Russia. Similar fates were experienced by Vladimir Kuznetsov in Primorsk and Yuri Matochkin in Kaliningrad (Hanson et al. 2000). Ironically, unlike new governors elsewhere, Yevgeny Mikhailov was not (at least, not pronouncedly) the choice of the local business elite. Though originally from Pskov, he came from LDPR headquarters in Moscow.⁸

Thus, Pskov had the first governor in Russia belonging to Zhirinovskiy's faction. The LDPR's victory in Pskov was not, however, a coincidence. At the 1993 State Duma election, the party received 43 % of the vote, and 21 % in the 1995 election. As described in the preceding chapter, Pskov's economy had experienced a dramatic collapse, and the region was a host to a number of army units. In addition, border disputes with Estonia and Latvia as well as numerous "ethnic refugees," i.e. Russians from other parts of the former SU, prepared the ground for Zhirinovskiy nationalistic rhetoric. (RRR 6.11.1996.) Even though Mikhailov himself is originally from Pskov, he manned his leading cadre mostly with young LDPR functionaries, inexperienced in administration and picked from around the country. Mikhailov quickly nominated ten deputy governors, only one of which was originally from Pskov and two who were not even Russian citizens. Against their expectations, the Communists were not given the influential positions in Mikhailov's cadre that they had coveted.

Governor Mikhailov's ideas on the basic principles for the economic policy of Pskov are based on the "Pskov" model created by his 7th alternate, Vladimir Ivtsenko. The model rests mainly on supporting the LDPR, and its principles date from the Soviet era. Under Mikhailov's leadership, the Pskov administration began actively undermining many of Tumanov's reforms, for example, by re-subordinating the local administration to the regional administration. The economic policy of the LDPR is based on developing a few key sectors and increasing the power of regional administration and regulation. The regional administration was especially active in its attempts to control the production and retail sales of alcohol via the state-owned Pskovalko. Demanding import fees and laboratory tests for all imported alcoholic beverages discouraged the import of alcohol from other parts of Russia. These measures were introduced to increase the excise duties on alcohol payable to the regional coffers, but there is no evidence they worked. Under the Pskov model, the state takes a strong and active role in the economy, and enterprises are directly subject to

regional administration regulation.⁹ Pskov strives to protect itself from external attempts of exploitation, for example, by restricting export of unrefined raw materials and subordinating some industries to state monopolies. The most profitable enterprises are collected under holding companies controlled by the regional administration. Ivtsenko has been openly hostile to foreign investment (Slider 1999).

Novgorod and Pskov have appeared to be opposites when it comes to political behaviour. Novgorod voters have tended to choose pragmatic individuals to run the region; parties have had little power. Independent candidates have been much more popular than party candidates in Novgorod, especially in local elections. Most representatives in the regional parliament and the Novgorod City Duma are independent. The power in Novgorod is held by a group of young, reform-minded bureaucrats and businessmen supporting the Federal government (first the NDR and more recently the Yedinstvo). In 1991, President Yeltsin appointed Mikhail Prusak, 37, governor of Novgorod. He was re-elected in December 1995 and again in September 1999 by a landslide of more than 90 %. The regional administration is considered reformist, relatively open and contrary to many Russian regions, relations between regional and local administration are good. There is a healthy consensus on regional development, and the regional administration has emphasised its efforts to co-operate with the local administration.¹⁰ In Pskov, the relations between the regional administration and the administration of the city of Pskov can best be described as tense. Mikhail Khoronen, who won the mayoral elections in spring 2000, is believed to be “more co-operative” with Mikhailov.

From the beginning, the economic policy of the Novgorod regional administration has aimed at developing a favourable environment for domestic and especially foreign investments. This has been based on tax relief, land sales to investors and maintaining open relationship between investors and the regional administration. Novgorod economic policy also favours the establishing of small enterprises, whose increasing numbers have partly compensated for the collapse of the old electronics industry. Novgorod’s regional administration has been praised for creating an investor-friendly attitude and for consistently pursuing policies that facilitate the entry of new investment projects. For example, the region has succeeded in credibly committing itself to guarantee “unaltered starting conditions” (*neuhudshenii startovih uslovij*) for all new investments in the region. In a country where many would rank conflicting and constantly changing local regulations as the single biggest obsta-

cles for economic activity, the approach taken in Novgorod should be good news for regional economies.¹¹

The image that Novgorod has created for itself has relied heavily on Governor Prusak, a member of the Federation Council and chairman of the Foreign Relations Committee. Mr. Prusak actively participated in the recent discussion about reforming the federal structure and the role of the Federation Council. He was one of the three governors who last spring wrote an open letter to then acting president Putin proposing e.g. that governors would be nominated by the president and that the governors should no longer be members in the Federation Council.¹²

In all federal elections held in the 1990s, the turnout percentage in Novgorod has been lower than in Pskov. The Communists and the LDPR have also enjoyed greater support in Pskov. The recent political tendencies in both regions are revealed in the outcome of the December 1999 Duma elections. The Communists kept their support level or even slightly increased it during the latest elections in both regions, while the pro-Putin Yedinstvo-party got the majority of votes in both regions.¹³ In Pskov, the shift is clearly a reflection of Governor Mikhailov's strong influence in the region, while Yedinstvo's victory in Novgorod must have been a slight defeat for Prusak who was known to support the old party-of-power NDR. Prusak also failed to get his candidate elected to the region's single Duma seat. By the time of the presidential elections in March 2000, the influence of the LDPR in Pskov came to an end as Mikhailov publicly abandoned his LDPR membership to become the leader of the Pskov branch of the pro-Putin party-of-power Yedinstvo.

In November 2000, a new governor will be elected in Pskov. Current public opinion polls show a strong support for Mikhailov. Although he has been unable to improve the region's economy, he has finally succeeded in gaining the support of significant part of the regional elite. His position is further strengthened by the lack of an organised opposition and well-controlled local media.¹⁴ Only his former ally and economic advisor, deputy chairman of the Duma budget committee, Mikhail Kuznetsov, has lately been campaigning against Mikhailov. However, his attempts have been largely turned down by Mikhailov's greater influence in the region.

Despite the LDPR-style populist rhetoric,¹⁵ there have been some cautious changes in Pskov's economic policy, witnessed especially by attracting investments. The act on investments of 1996 was amended in March 1998, providing for additional benefits for enterprises investing in the region. The

objective of the amended act is to give investors at least as good benefits as those given in the neighbouring regions, especially in Novgorod. Further, the importance of creating a positive investment image for the region has been emphasised. So far this change of policy has not produced a large influx of foreign investment capital, and it remains to be seen how the new investment act will operate in practice. A lot remains still to be done before the investment environment in the region is good enough to allow major foreign investments to enter. After that a few successful foreign investments would certainly increase the general interest of foreign investors towards the region.

In addition to its new investment policy, the Pskov administration has set supporting manufacturing industry by legislative changes and financial means as one of the objectives of its economic programme for 1998-2000. Experts will be trained for the needs of the manufacturing industry also abroad if necessary. One key objective is to narrow the gap in standards of living compared to the neighbouring regions. Compared to Novgorod, the gap in both living standards and industrial production has been constantly widening since 1993 (see Table 2).

The different strategies for economic reform chosen by Novgorod and Pskov are clearly reflected in the amount of foreign investments. Assuming that investing in a certain region during economic reform is always risky for foreign investors, this may indicate a good deal about the general progress of economic reform in these regions. The number of foreign enterprises and investments has increased rapidly in Novgorod (Table 5). In 1995 – 1999 Pskov received only some 7 % of the amount of foreign investments of Novgorod.¹⁶ The differences are also clear when comparing the significance of export to the industrial production of these regions. In Novgorod, exports accounted for 45 % of industrial production in 1998, compared to 0.2 % in Pskov and a federal average of 43 %.¹⁷

Novgorod's success is also evident in several surveys assessing regional investment climate, in which it has scored well. Novgorod placed extremely well in the December 1996 classification of investment risk in Russia's regions conducted by *Expert* magazine and also scored high in equivalent classifications made in 1997 - 2000. Novgorod's main benefits compared to other regions have been a flexible attitude of regional administration towards investors, solid legislation and tax breaks.

4 Preliminary conclusions

Novgorod and Pskov share a common history, geographic proximity and similar resources, but their policy choices during the transition period have been quite different. Based on a relatively short period of examination and only a few indicators, the largest difference appears to be in attracting foreign investment. Assuming that investing in a certain region during economic reform is always a great risk to foreign investors, this figure may indicate a good deal about the general progress of economic reform in these regions. At least, the region must be able to give sufficient assurances to the investors that key requirements are fulfilled. The amount of FDI may also be a relatively good indicator of the overall business environment in the region. Brock (1998) finds that across Russian regions relatively higher FDI per capita figures tend to go together with indicators on lower crime, bigger market size and less risk. His findings seem to be in line with ours. Novgorod region that has been praised for creating safe and manageable investment climate has succeeded in attracting far larger FDI inflows than Pskov.

Moreover, as majority of foreign investment in Novgorod has been greenfield and not directed to the old military-oriented branches, we are tempted to conclude that in attracting FDI, Novgorod has been unable to benefit much from its more diversified industrial structure inherited from the Soviet times. On the other hand, if inherited industrial structure does not matter much in attracting foreign investment, then the only visible difference between these two regions is their economic policy. Here, we must note that the concentration of military industry in Novgorod probably gave the region a relative advantage compared to Pskov in terms of more highly educated and highly skilled labour force. Still, new enterprises have found it necessary to train local staff. Thus, our first (preliminary) conclusion is that policies seem to matter at least in some areas of regional economic development. Further, we argue that the outcomes of regional policies may not always be negligible or injurious as concluded in Hanson-Bradshaw 2000. In some areas, regional governments may conduct policies that promote new investments and facilitate business entry. These factors should in a longer term show up in regional growth figures.

While it is still too early to draw conclusions about the purposefulness and continuity of Pskov's new investment-oriented economic policy, it seems that a degree of imitation is taking place. Novgorod's success in attracting new

investments has been used as a model for Pskov's new policies. Thus, there is some, albeit weak, evidence on competition and imitation between Russian regions. Another possible example of regional imitation is the often-cited anti-reform case of the Ulyanovsk region. Ulyanovsk, probably the most red of all Red Belt regions in southern Russia, conducted economic policies based on e.g. price controls, exports restrictions and heavy taxation on the private sector. In some studies, Ulyanovsk was used as a good example of regional economic policy favouring low criminalisation and low price level in the region.¹⁸ However, the region abandoned formal price controls at end of 1996, and there is at least some evidence that economic policy of the region is approaching those of neighbouring regions (Hanson 2000).

If this trend continues, this should in our opinion be good news for Russia's transition process. A benefit of decentralising economic decision-making is that it allows for regional experimentation and competition. If regional governments operate under hard budget constraints, regional competition should eventually make inefficient regional policies unsustainable and lead to imitation of more efficient practices. In the next stage of this study, we want to gather more precise information about the economic policies of the two regions in question.

It remains to be seen how the Putin era will affect relations between regional administrations and the centre, as well as the economic policies pursued in Pskov and Novgorod. The collapse of the LDPR in Pskov and the subsequent rise of Yedinstvo may have influence on the future economic policy pursued. Some observers have noted that the end of the Yeltsin regime could bring hard times for Mr Prusak, who was suddenly deprived of his party affiliation. In fact, it seems that Prusak has succeeded in keeping good relations also with the Putin administration. He was elected to the board of the electricity monopoly UES in June 2000 as one of the three governors elected to represent regional interests. At the moment, both Mr. Mihailov and Mr. Prusak have stressed their willingness to co-operate with the new masters in the Kremlin.¹⁹ It is also far too early to assess the impact of the new federal districts on Novgorod and Pskov.

Appendix 1

Table 1 Basic indicators

	Novgorod	Pskov
Population (Jan. 98)	736,900	827,100
Land area, km ²	55,300	55,300
Population density persons / km ² (Jan. 98)	13.3	14.8
Russians, % of total population	95 %	94 %
Urban population (1997)	71 %	66 %

Source: Goskomstat

Table 2 Standard of living indicators

	Novgorod	Pskov	Russia
Monthly income per capita, roubles (Jan. 00)	1320	719	1431
Average monthly wage, roubles (Jan. 00)	1531	1332	1830
Subsistence minimum, roubles (Nov. 99)	832	793	943
Persons living below the poverty line, % (1998)	18.8	37.8	23.8

Source: Goskomstat

Table 3 Value of agricultural production, RUB billion²⁰

	1991	1992	1993	1994	1995	1996	1997	1998
Novgorod	1.6	12.0	103.9	372.0	1249.1	1720.9	1626.1	1637.5
Pskov	2.2	18.9	181.4	575.0	1798.4	2235.5	2337.9	2044.6

Source: Goskomstat

Table 4 Value of industrial production, RUB million

	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	1-2/00
Novgorod	2	2.5	5.3	63.4	462	1407	3991	4959	4655	6981	14319	2806
Pskov	1.9	2.4	5.3	50.4	352	944	2329	2891	2695	2702	5079	994

Source: Goskomstat

Table 5 Developments of foreign investments in Novgorod, USD million

	1992	1993	1994	1995	1996	1997	1998	1999	1H2000
Cumulative	153.3	153.6	157.1	226.2	394.2	489.9	552.9	652.9	682.9
Annual		0.3	3.5	68.6	168	95.7	62.6	100	30

Source: Novgorod regional administration

Table 6 Foreign investments to Novgorod and Pskov, USD thousand

	1995	1996	1997	1998	1999
Novgorod	25000	31000	94000	44000	88062
Pskov	1000	10000	1000	4000	2835

Source: Goskomstat

Table 7 Production by industry in Novgorod, Pskov and Russia, 1997
(% of industrial production)

	Electricity production	Wood processing	Chemical industry	Machine construction	Food industry	Light industry	Metal-lurgy
Novgorod	16.5	10.9	31.4	11.2	16.8	0.6	5.6
Pskov	24.2	3.5	0.2	31.7	22.7	5.3	0.2
Russia	17.1	3.7	7.2	18.8	12.4	1.8	13.4

Source: Goskomstat

Table 8 Production by industry in Novgorod, Pskov and Russia, 1995
(% of industrial production)

	Electrical production	Wood processing	Chemical industry	Machine construction	Food industry	Light industry	Metal industry	Other
Novgorod	12.8	13.0	33.2	13.4	11.3	1.1	6.8	8.4
Pskov	15.6	4.8	0.1	34.4	23.9	7.2	0.2	13.8
Russia	12.5	5.2	8.1	18.2	12.1	2.5	15.9	25.5

Source: Goskomstat

Table 9 Votes received by three largest parties

	LDPR	Party of Power	Communist Party
Novgorod 1993	29.6	13.21	9.25
Pskov 1993	43.01	10.13	9.5
Novgorod 1995	12.13	10.51	18.02
Pskov 1995	20.87	6.01	22.65
Novgorod 1999	7.1	32	19.4
Pskov 1999	7	38.3	23.5

Source: NUPI database and Russia's general election committee. The 1993 party of power was DCR, 1995 NDR and 1999 Medved.

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Notes

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¹ For a recent overview of the literature, see Hanson-Bradshaw (2000).

² Earlier comparisons between these two regions appear in Kuznetsova (1998) and our earlier (1998) version of this paper.

³ For a slightly more detailed presentation of the history of these regions, see the 1998 version of this paper.

⁴ This naturally has something to do also with the fact that Russia charges goods imported from Estonia twice the import tariffs charged on other imports.

⁵ Hanson et al. 2000 discusses the cases of Kaliningrad and Primorsk.

⁶ Hanson (1996 and 1997) classifies Novgorod as one of the ten high-tech areas in Russia. The classification is based on jobs in the military industry in the following industries: aerospace, radio, communication and electronics. Pskov is classified as “Ordinary Russian regions,” whose outlook does not appear particularly good.

⁷ Yeltsin nominated Tumanov as the Governor of Pskov in May 1992.

⁸ According to his personal cv posted in <http://www.pskov.ru/region/admin.html>, Mikhailov lived in Moscow from 1983 to 1996 while being a member of the Duma elected from Pskov district in 1993 and again in 1995.

⁹ The basic tune has not changed much. In an interview in *Pskovskaya Pravda* on July 15, 2000 Mihailov praised the region’s success in turning “dead beat” alcohol producers into obedient taxpayers (by nationalising them).

¹⁰ We are, however, aware of the fact that very close connections between regional and local administrations and regional branches of federal institutions alike, may well lead to an insider-controlled political regime instead of promoting purely democratic institutions. For an example, see the article *Kogda prokuratori ne strashni* in *Nezavisimaja Gazeta* on 27.6.2000.

¹¹ The former country manager of Cadbury, Isbren Klein said that the attitude of the regional administration in Novgorod was the number one priority for them (in making their location decision). EIU interview, 13 Oct. 1999.

¹² The latter of the above mentioned proposals was included in the new laws on the Federation Council that Putin pushed through in July. The open letter was published in *Nezavisimaya Gazeta* on 25 Feb. 2000.

¹³ Yedinstvo received 38 % of total votes in Pskov and 32 % in Novgorod. The Communists and the LDPR together got fewer votes than Yedinstvo alone, i.e. some 30 %. In the 1995 Duma elections they got about 44 % of the votes in Pskov. In detail, the change has occurred only in the support of LDPR, which has fallen from over 20 % to a mere 7 %.

¹⁴ The same does apply to governor Prusak as well.

¹⁵ Most recently, Mihailov has criticised federal decisions on raising excise taxes on alcohol and gasoline.

¹⁶ The comparison is made using Goskomstat figures on foreign investments. The regional administration of Novgorod has its own figures on foreign investments, which differ, sometimes quite noticeably, from the Goskomstat figures.

¹⁷ The figures are calculated using Goskomstat information.

¹⁸ For a good description of the Ulyanovsk model, see McIntyre 1998.

¹⁹ Both governors e.g. reportedly voted for Putin's new proposal for reforming the Federal Council already in the first vote.

²⁰ The figures in the tables are nominal, since the regional time sequences on inflation were not available.

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