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# Review of Economies in Transition

## Idäntalouksien katsauksia

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1998 • No. 6

21.12.1998

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Reprint in PDF format 2002

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Economic Policy Can Influence Economic  
Development**

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ISSN 1235-7405  
Reprint in PDF format 2002

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Laura Solanko - Merja Tekoniemi

## Novgorod and Pskov - Examples of How Economic Policy Can Influence Economic Development

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### 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 in reform to policies that would attract foreign investments in production. Pskov, on the other hand, drew back 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.

Keywords: Russia, regions, economic policy

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## 1 Introduction

This paper examines two Russian regions to compare how differences in economic policy affect economic performance of a region. This paper focuses on two regions (*oblasti*) in the Russian Northwest: Novgorod and Pskov. Since Novgorod and Pskov had similar starting points in 1990 in terms of geography, territory, population, history and natural resources, these regions provide an interesting subject for developmental comparisons. The structure of industry in the two regions was inherited from the Soviet period, so here they differ slightly. Novgorod was a major military-industrial centre in northwestern Russia, whereas Pskov was more inclined towards agriculture and light industries. Nevertheless, both regions have suffered large declines in industrial production. From Moscow's point of view, both Novgorod and Pskov are small, poor, and lack the prerequisites for rapid economic growth.

Novgorod's economic performance has been consistently better than its neighbour's. It has succeeded in attracting large flows of new investments, especially foreign green field investments. Pskov's economy, on the other hand, has declined since 1991 much faster than the Russian average. This paper attempts to find reasons for the differences in economic performance. One factor that seems to be extremely important is political orientation. Novgorod committed early on to reform-minded policies that would attract foreign investment. Pskov drew back 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.

## 2 A tale of two city states

By the 9<sup>th</sup> century, both Novgorod and Pskov were important trading centres strategically situated at the confluences of major rivers. They dominated key trade routes during the

early Middle Ages. Pskov oversaw navigable waterways to the Gulf of Finland. Novgorod controlled the trade route of the Varengians, which stretched from Lake Ladoga to the Black Sea.

Novgorod gained importance in the 12<sup>th</sup> century as a significant intermediary for trade between East and West. Its influence as a trading centre eventually extended west to the Savo region in Finland, north to Arctic Ocean, and east towards the Urals. Pskov meanwhile lagged economically and politically. Regularly besieged by Teuton armies, Pskov played for centuries the thankless role of buffer zone for its ever-richer neighbour until Alexander Nevsky vanquished the Teutons on the ice of Lake Peipus in 1242. Thereafter Pskov gained in power and influence. The Treaty of Pähkinäsaari, concluded in 1323, ended the hostilities between Novgorod and Sweden over the control of Karelia. In the early 14<sup>th</sup> century, Pskov was declared an independent boyar republic.

Novgorod and Pskov enjoyed economic and political golden ages during the 15<sup>th</sup> century. Both towns were headed by elected princes whose powers were exclusively judicial. Assemblies of free men, or *veches*, decided on war and peace, and made the important appointments. Eventually, however, both city-states were forced to acknowledge the supremacy of Moscow. The sovereign form of government developed in Moscow replaced the fairly democratic traditions of Novgorod and Pskov.

Although Novgorod and Pskov were relatively remote frontier areas from the viewpoint of the new capital, both remained lively trading centres in the 16<sup>th</sup> and the 17<sup>th</sup> centuries. The founding of St. Petersburg on the shores of the Gulf of Finland seriously eroded the economic significance of these ancient powers as trade and merchants moved to the new capital. Russia's expansion to the Baltic states and Poland meant that Pskov lost its strategic importance as Russia's outpost against the West. By the turn of the 19<sup>th</sup> century, Pskov was but a small provincial town of about 20,000 inhabitants.

In February 1918, German troops occupied the Pskov region in order to force the interim government of Soviet Russia to accept the terms of the Brest-Litovsk Treaty. After Germany surrendered in November, the Pskov region remained in the hands of the white troops operating from Estonia. Fierce battles over the control of the region continued until the end of 1919, when the Red Army succeeded in establishing its position. During the Second World War, the German blitzkrieg swept over Pskov and Novgorod; both were occupied for nearly three years. Both regions suffered massive losses of life and property. The historically significant town centres were extensively destroyed.

After the war, Novgorod and Pskov were administratively separated as distinct regions, and massive reconstruction began. Such industries as radio electronics, optics and chemical production were centralized in Novgorod, making it the largest military-industry 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 the cutting of cooperation ties established after the War, especially with Riga.

### 3 Similar resources

The Novgorod and Pskov regions are situated in the northwestern economic area of Russia surrounding St. Petersburg. Despite their high latitudes, they have a fairly temperate continental climate. Novgorod lies along the main highway between St. Petersburg and Moscow. The Leningrad, Pskov, Tver and Vologda regions border Novgorod. Pskov is bordered on the east by the Leningrad, Novgorod and Smolensk regions; on the west it has common borders with Belarus, Latvia and Estonia. Potentially, both regions have excellent locations for becoming significant trading centres in the future. In terms of land area, the regions are almost identical.

Neither of the regions have precious natural resources. The most important and valuable natural resource is wood; 65% of the Novgorod region and about a third of the Pskov region is forest. 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.

Pskov has slightly more inhabitants than Novgorod. Both areas are ethnically homogeneous: non-Russians comprise only a few percent of the population so ethnic conflicts are rare. Pskov has had a large influx of "refugees" from other CIS countries after the disintegration of the Soviet Union. Even so, the populations in both regions have gradually declined throughout the 1990s. Urban population is 65% in Pskov and 71% in Novgorod, i.e. only slightly lower than the 73% average for the Russian Federation. The average age in both regions is about 38 years. According to Goskomstat, the social indicators, such as the ratio of doctors or hospital beds to one thousand inhabitants, are roughly the same in both regions.<sup>1</sup>

The town of Novgorod has 230,000 inhabitants and the second largest town, Borovich, about 61,000. The Novgorod region consists of 21 local administrative units, or *rayons*. The Pskov region has 24 *rayons*, which correspond to municipalities in the West. The Pskov region has two large towns, Pskov with 207,000 inhabitants and Velikie Luki with about 117,000 inhabitants.

Table 1 **Basic indicators**

	<b>Novgorod</b>	<b>Pskov</b>
Population 1.1.97	739,300	827,100
Land area, km <sup>2</sup>	55,300	55,300
Population density 1.1.97 persons / km <sup>2</sup>	13.4	15.1
Russians, % of total population	96 %	93 %
Urban population 1996	71 %	65 %

#### 4 Different industrial structures and income level

The different industrial structures of Novgorod and Pskov strongly 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 light industry such as clothing. Chemical and radio technology industries serving the military industry were centralized in Novgorod. Even though army procurement has dried up in recent years, the relatively high-tech industrial enterprises in Novgorod have better possibilities to find other lines of production than the badly hit light industry enterprises.<sup>1</sup> This is evident when comparing standards of living.

The industrial structure inherited from the Soviet Union is most clearly reflected in that *agricultural production* has remained far more important to Pskov than to Novgorod. In 1993, its value was more than twice that of the Novgorod region and even in 1995, Pskov produced about 40% more than Novgorod. The importance of agriculture in Pskov is high even at Federation level. The value of agricultural production per capita was more than 40% higher than on average in Russia (in Novgorod, this figure was 10% smaller than the Russian average). The importance of agriculture to Pskov can also be seen in comparison of the breakdown of labour force by industry in these regions (see Table 5 "Breakdown of labour force").

<sup>1</sup> Eg 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.

Table 2 **The value of agricultural production, billions of roubles<sup>2</sup>**

	1991	1992	1993	1994	1995
Novgorod	1.6	12	103.9	372	1296.2
Pskov	2.2	18.9	181.4	575	1831.5

Source: Regioni Rossii

Despite the increase in the nominal value of agricultural production, the real production decreased extremely strongly in both regions. According to the customer price indices of 1994 and 1995, the price level in Novgorod was about 10% higher than in Pskov. It may be assumed that the difference in price levels has remained roughly the same.<sup>3</sup> It is difficult to find a clear and unambiguous reason for the higher price level in Novgorod. Neither region has been remarkably hasty in dismantling the remains of price control. The share of subventions in budgetary expenditure is still significant. (Uljukayev 1998, 8) According to the 1995 and 1996 statistics, Novgorod controlled goods and service prices slightly more than Pskov. However, Pskov has subsidized agricultural production far more than Novgorod.<sup>ii</sup>

*Industrial production* accounts for almost half of Novgorod's GDP (48%). Construction (11%), agriculture (10%), trade (5%) and industrial production comprise together almost 90% of Novgorod's GDP. Chemicals, machine building and forestry are the most important industries. The city of Novgorod was an important centre of electronics industry in the Soviet Union; one-third of the town's labour force was employed in electronics, with about 80% of production going to the military. With the disintegration of the Soviet Union, electronics production fell; only television manufacturing has stayed afloat. Most of Novgorod's industrial production is now

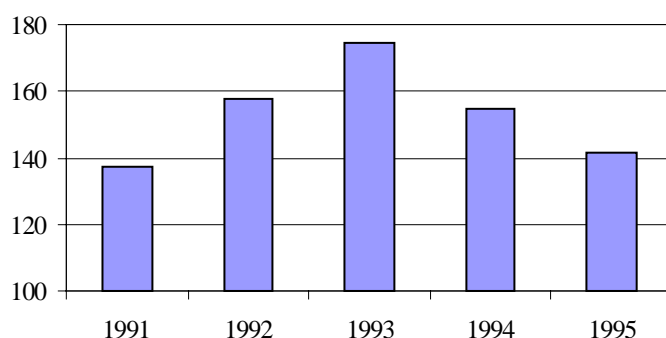
<sup>2</sup> The figures in the table are nominal, since the regional time-sequences on inflation were not available. Therefore, these figures can only be used in comparing Novgorod and Pskov.

<sup>3</sup> In August 1997, the cost of living index in Pskov was 84.4 and 92.4 in Novgorod (VF = 100) (EIU Business Russia Dec 1997).

chemicals, especially fertilizers. (Zimine 1998) The most important industries in Pskov are machine building (one third of the value of industrial production in 1995), food processing and electrical power generation. The Pskov region has a number of hydroelectric stations. It produces a surplus of electricity, some of

which is exported to Belarus. Pskov's light industry produces garments, shoes and linen cloth. Two-thirds of industrial production in the region is concentrated in the towns of Pskov, Velikie Luki and Ostrov.<sup>iii</sup>

Figure 1 The value of agricultural production in Pskov, % of Novgorod's level



Source: Regioni Rossii.

Table 3 Production by industry in Novgorod, Pskov and Russia, 1995 averages, % of total 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: Regioni Rossii.

In the first half of the 1990s, industrial production in Novgorod developed more favourably than the Russian average. In Russia this means slower contraction of industrial production in Novgorod than in the whole Russia. However, this trend does not favour economic reform if accompanied by support to old state-owned and non-profitable structures. It is difficult to say to what extent this applies to Novgorod, but already by 1996 the decline of industrial production compared to the production in 1990 matched the decline in the whole Russia. In 1996, the industrial production was

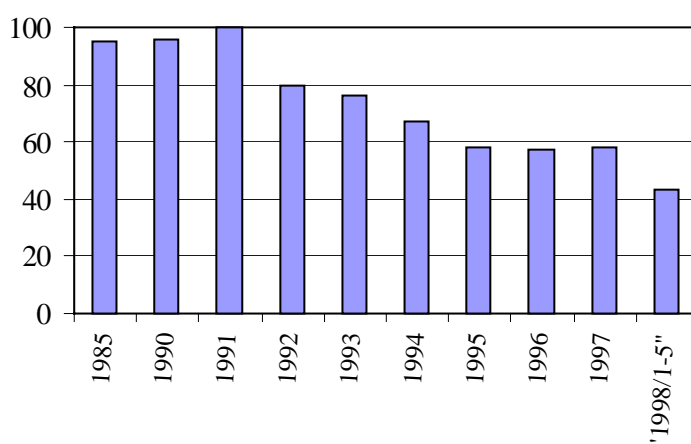
half of the 1990 level, and its value was 4,260 billion roubles.

In Pskov, the industrial production declined more rapidly in 1990-1996 than in Novgorod and in Russia on average. In 1996, the production was only 27% of the level six years previously. Its value, 2,446 billion roubles, was about 0.2% of the production of all Russia. This sharp decline was not apparently accompanied with significant restructuring of enterprises.

Table 4 **The value of industrial production, billions of roubles<sup>4</sup>**

	1985	1990	1991	1992	1993	1994	1995	1996	1997	"1998/1-5"
Novgorod	2	2.5	5.3	63.4	462	1407	3991	4260	4655	2563
Pskov	1.9	2.4	5.3	50.4	352	944	2329	2446	2695	1112

Source: 1985-1995 Regiony Rossii; 1996 Posle vikorov; 1997-1998 Goskomstat monthly macro reports.

Figure 2 **The value of industrial production in Pskov, percentage of Novgorod level**

In 1997, when the GDP and industrial production in Russia grew for the first time since the beginning of the economic reform (0.8 and 1.9% compared to the 1996 level), the decline of industrial production also reversed in Novgorod and Pskov. In January-May 1998, industrial production grew considerably in Novgorod (3% as compared to January-May 1997) and Pskov (8.8%). Industrial production in all Russia grew 0.6%. The growth of industrial production in Novgorod was motored by the paper production with its 10% growth. Pskov's growth was concentrated in the vital industry of machine building, which grew 1%.

Meat production, for example, fell to just over half of the 1997 level.

The value of industrial production in Pskov has constantly declined compared to Novgorod – in 1990 the production values were almost equal, but in January-May 1998 the value in Pskov was only 43% of the level in Novgorod.

Based on breakdown of employees by industry, the service sector is equally important in both regions, and has grown considerably since 1990. While the labour force has apparently moved from manufacturing to the service sector, the share of agricultural workers in both regions has declined only slightly. It would

<sup>4</sup> The figures in the table are nominal, inflation time series were unavailable.



appear that the economic restructuring from manufacturing to the service sector has been

more pronounced than on average in all Russia.

Table 5 **Labour force in manufacturing industry, agriculture and service sector, % of total**

	Manufacturing		Agriculture		Services and other	
	1990	1994	1990	1994	1990	1994
Russia	30.3	27.1	12.9	15	56.8	57.9
Novgorod	36	31.4	12.8	12.2	51.2	56.4
Pskov	30.2	26.7	18.3	17.5	51.5	55.8

Source: Atlas of economic performance

The different production structures reflect the standards of living in these two regions, both in terms of income level and in number of people living below the poverty line. However, even considering the higher price and income levels in Novgorod than in Pskov, it is interesting to note that before the economic reform, the income per capita and the average salary were the same in both regions. Differences emerged only after 1990. In January-May 1998, the real income in Novgorod had risen slightly under 7% compared to January-May 1997, whereas in Pskov it had declined 3%. In April 1998, monetary income per capita in Pskov was two-thirds of the monetary income

in Novgorod. The share of expenditure on consumer goods of money income was at the same level in both regions (about 65%). The price level in April 1998, based on a basket comprising 25 basic foodstuffs, was 3% lower in Novgorod and 7% lower in Pskov than in the whole Russia. The average salary per capita was 77% in Novgorod and 66% in Pskov of the federal average. When social security payments are added to the average salary, the situation evens out so that Novgorod exceeds the Russian average by 1.5%, while Pskov falls slightly below.

Table 6 **Standard of living in Novgorod, Pskov and Russia**

	Novgorod	Pskov	Russia
Money income per capita (04/98, roubles)	787	519	916
Average salary + social security (04/98)	824	703	1074
Subsistence minimum (04/98)	373	354	432
Average salary + social security, % of the subsistence level (04/98)	197	177	221
Persons living below the poverty line (1995)	23	43	25

Source: Goskomstat monthly macro reports.

According to official statistics, unemployment is slightly lower in Novgorod than in Pskov.<sup>5</sup> At the beginning of 1997, unemployment was slightly under 2% of all inhabitants<sup>6</sup> in Novgorod and 2.5-3% in Pskov. During 1998 unemployment has decreased in Pskov.

## 5 Different political orientations

The sitting Governor of Pskov, Vladislav Tumanov<sup>7</sup>, who was backed by the national power elite and also by Yuri Luzhkov and Vladimir Yakovlev, lost the election in November 1996 to Yevgeny Mikhailov, 33, of Zhirinovskiy's faction. Even though Tumanov won clearly the first round of the election, on the second round Mikhailov received 57% of the vote, mainly from Communist and LDPR supporters. The high turnout percentage in the second round (60.2%) gives cause to presume that there were a significant number of protest votes. Therefore, Pskov has the first – and so far the only – 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. Pskov's economy collapsed, 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 Federation, prepared the ground for Zhirinovskiy nationalistic rhetoric.<sup>iv</sup> 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. The Oblast Duma elections in April 1998 did not bring any significant changes to the political field. Mikhailov's opponents only received a couple of seats in the Oblast Duma, and the majority continued to reside with directors of state farms and large enterprises.

The turnout percentage in Novgorod has been lower than in Pskov in all federal elections held in the 1990s. The Communists and the LDPR have also gained more support in Pskov. 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. Only 5% of the region's inhabitants belong to a political party.<sup>v</sup> The power in Novgorod is held by a group of young, reform-minded bureaucrats and businessmen supporting the Federal government and the NDR. Governor Mikhail Prusak, 37, who heads the region, was re-elected in December 1995.<sup>8</sup> The regional administration is considered to be reformist and relatively open. The relations between regional and local administration are also considered as good. There have not been any large differences as regards regional development, and the regional administration has emphasized its efforts to cooperate with the local administration.

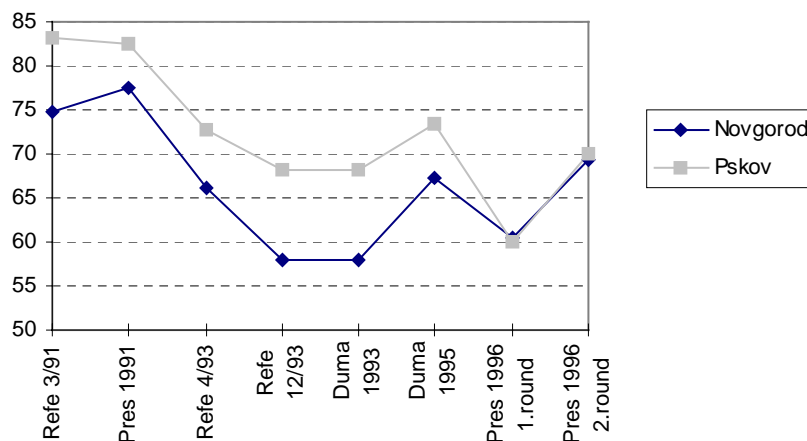
<sup>5</sup> In this context, the quality of the official unemployment statistics in Russia has to be kept in mind; they do not give truthful information about the real extent of unemployment in Russia and its regions..

<sup>6</sup> Unemployment given as a percentage of population due to lack of figures on labour force.

<sup>7</sup> Yeltsin nominated Tumanov as the Governor of Pskov in May 1992.

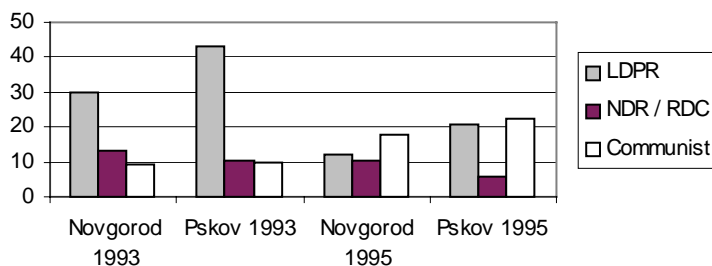
<sup>8</sup> Mr Yeltsin appointed Mr Prusak Governor of Novgorod in 1991.

Figure 3 Turnout as percentage of the people entitled to vote



Source: NUPI database

Figure 4 The votes received by the three largest parties in the State Duma elections in Novgorod and Pskov, % of the votes cast



Source: NUPI database

Novgorod and Pskov appear to be opposites in their political behaviour. Novgorod voters choose pragmatic individuals to run the region; parties have little power. Similar behaviour is seen in eg Moscow and Nizhni Novgorod. These non-aligned regions and their administrations are characterized by cooperation with various economic and political groups; therefore, the administration is rather stable. Regions like Pskov are less stable, political parties (mainly the Communists) are firmly established, and conflicts between the political and economic elite are more pronounced. This

pattern is evident also in Karelia and Sverdlovsk.

## 6 Different economic policies

In the Soviet era, the Novgorod economy was largely dependent on the electronics plants serving the military. After economic reform had begun, regional development had to be started on a new basis. Novgorod economic policy favours the establishing of small enterprises, whose increasing numbers have partly

compensated for the collapse of the electronics industry. The economic policy of the Novgorod regional administration has from the beginning 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. A good example of the latter is the extensive cooperation programme between the US and Novgorod, "Novgorod regional partnership initiative" (total budget USD 10 million). The image that Novgorod has created for itself has relied heavily on its Governor Prusak, a member of the Federation Council and chairman of its Foreign Relations Committee. Prusak is considered as one of Russia's young reformist leaders.

At the start, Pskov's economic reform suffered from a lack of reformist and visionary leaders. The former Governor Vladimir Tumanov, backed by the Russian Government, was unable to reform Pskov quickly and visibly enough, and was succeeded by Mikhailov. Under Tumanov's leadership Pskov began to establish relations with foreign countries and to attract investments by various tax incentives. 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. Tumanov's actions for attracting investments were considerably more cautious than the campaigns of the Novgorod administration. However, he is credited for reforming the local administration; for instance, 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. The change of Governor in the 1996 election contributed in that attracting domestic and foreign investments remained at the starting line. (Slider 1997.)

Governor Mikhailov's ideas on the basic principles for the economic policy of Pskov are based on the "Pskov" model created by his 7<sup>th</sup> 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 undermining many of Tumanov's re-

forms; for example, by again 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 discourages 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 has a strong and active role in the economy, and enterprises are directly subject to regional administration regulation. 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. Ivtshenko has been openly hostile to foreign investment. (Slider 1997.)

Against this background, the recent turnabout of Pskov seems surprising. Despite the fact that Mikhailov is still Pskov's Governor, there have been some cautious changes in its 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 to the region has been emphasized. 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. It would be important for Pskov to attract a few key foreign investments to show the world with a practical example how hard the region is working to increase investments.

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 as necessary. One key objective is to narrow down the gap in standards of living compared to the neighbouring regions.

Both regions – as well as other north-western regions in Russia – receive aid from the Federal Fund for Financial Support. However, Novgorod 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 nevertheless 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. As the federal income transfers decrease, the Pskov region may be faced with grave difficulties.

At least in 1997 there were no signs of the Federation leaving promised income transfers to Pskov unpaid, despite a number of actions in breach of federal legislation. Apart from a few exceptions, the Federation representatives in Pskov have either not been able or unwilling to intervene in the actions of the regional administration. Novgorod has been more efficient in collecting revenues even though its economic reform strategy has been based on granting significant tax relief 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.<sup>vi</sup>

The different strategies for economic reform that Novgorod and Pskov chose from the start are most clearly demonstrated by the amount of foreign investments, which are most clearly affected by the progress of economic reform. The number of foreign enterprises and investments have increased rapidly in Novgorod (see Figure 5). At the end of 1997, 179 foreign enterprises operated in the region. Their aggregate investment totalled USD 490 million. In 1997, foreign enterprises or foreign associated undertakings accounted for over 40% of the industrial production of Novgorod and over 80% of exports. The corresponding

figures for all Russia were 3% and 9%. The largest investor countries are the United Kingdom (Cadbury), Denmark (Dansk Tyggegummi Fabric), Germany (Sommer) and Finland (Kymmene, Schauman Wood and Raute). The statistics for Pskov are not as comprehensive, but the aggregate value of foreign investments at the beginning of 1997 (USD 9.5 million) may give some indication.<sup>9</sup>

In the first quarter of 1998, the value of foreign investments placed in Novgorod was sixfold to the corresponding figure for Pskov. However, it would appear that the growth of foreign investments in Novgorod is slowing. If the influx of foreign investments to Novgorod remain at the level of the first quarter throughout the year, the total value of investments in 1998 will remain at slightly under one-fifth of the 1997 level. The reverse would appear to be true in Pskov: in 1997, the amount of foreign investments grew over 800% compared to 1996. Even in the first quarter of 1998, foreign investments to the region were nearly 60% of the total level of 1997. It has to be kept in mind, however, that despite these trends the amounts of foreign investments in these regions are in different leagues. Even though the enthusiasm for investing in Novgorod would decrease, investments in Pskov would have to multiply for several years to reach Novgorod's level.

The differences are also clear when comparing the significance of export to the industrial production of these regions. In Novgorod, exports accounted for 43% of industrial production in 1996 and 13% in Pskov with a federal average of 34%. In the survey conducted by the World Bank at the end of 1996, Novgorod placed sixth in the whole world as regards its investment environment. Novgorod placed extremely well in the December 1996 classification of investment risk

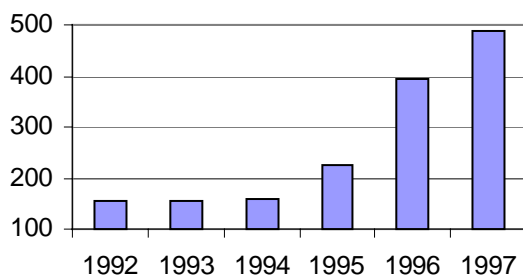
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<sup>9</sup> The number of foreign enterprises and foreign associated undertakings appear to have been higher in Pskov than in Novgorod in 1995 and 1996. However, most of the enterprises registered in Pskov are probably non-operational. In 1996, the value of the production of the associated undertakings in Novgorod was sevenfold to the corresponding figure for Pskov, even though the number of registered associated undertakings was much smaller.

in Russia's regions conducted by *Expert-magazine*. Novgorod region scored high also in

the equivalent classifications made in 1997 and 1998.

Figure 5 **Development of foreign investments in Novgorod, is USD million**



Source: Novgorod region administration

## 7 Conclusions

We compared the economic development of two regions, Novgorod and Pskov. They share a common history, geographic proximity and similar resources, but their policy choices have during the transition period been quite different. Based on a relatively short period of examination and only few indicators, the largest difference appears to be in the 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. Novgorod's main benefits compared to other regions have been a flexible attitude of regional administration towards investors, tax breaks and the possibility to purchase land. The emergence of reform-oriented growth centres like Novgorod could be extremely important for all of Russia. The example of successful regions would increase interregional competition and further the progress of economic reform.

Pskov reached its objective of protecting itself from external attempts of exploitation, at

least at the beginning of Mikhailov's governorship. While it is still too early to draw conclusions about the purposefulness and continuity of Pskov's new, more open and investment-oriented economic policy. At least as regards investments, the direction of reforms appears to differ completely from the previous policy.

Even though the chosen economic policy has in the light of this study appeared to have a significant effect on the economic development of these regions and attracting foreign investments, the differences in inherited production structure cannot be ignored. Despite their common history and similar resources, Novgorod has two structural benefits in addition to its more reformist administration: a slightly more advantageous production structure and more strategic geographical location – in the present situation – along the main highway between St. Petersburg and Moscow, the largest consumer centres of the country.

It is interesting to observe how Novgorod and Pskov will be able to compete with each other in attracting investments from other Russian regions and abroad, considering the clear head start of Novgorod. On the other hand, the positive publicity received by Novgorod and its well-developed (by Russian

standards) investment environment are not self-evident. According to preliminary information, foreign investments and other economic indicators show that the economic development in Novgorod in 1998 has not fulfilled the set objectives. Key persons in the regional administration have been replaced and new solutions have been sought. One of the

largest problems brought forward is the relationship between the federal central administration and the regions in general. Novgorod's Governor Prusak has openly pursued larger autonomy for the regions which is, given some reasonable limits, a rational prerequisite to the emergence of healthy interregional competition.

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